

ANNEX A

RESPONSES TO QUESTIONS OF THE PANEL IN THE CONTEXT OF THE FIRST SUBSTANTIVE MEETING

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ANNEX A-1

RESPONSES OF THE UNITED STATES TO QUESTIONS POSED IN THE CONTEXT OF THE FIRST SUBSTANTIVE MEETING OF THE PANEL

(24 September 2003)

Questions Posed to the United States

Q1. The United States claims that the "CWB Export Regime" is inconsistent with Article XVII:1 of the GATT 1994 (US first written submission, para. 105). The term "CWB Export Regime" is defined at para. 15 of the US first submission as comprising (i) the legal framework of the CWB, (ii) Canada's provision to the CWB of exclusive and special privileges, and (iii) the actions of Canada and the CWB with respect to the CWB's purchases and sales involving wheat exports. In this regard, please provide further clarification as follows:

(a) Is the United States claiming that the "legal framework of the CWB" as such (per se) is inconsistent with Article XVII:1?

1. The US claim is that the CWB's legal structure and its incentives to act in a non-commercial manner necessarily result in the CWB making sales not in accordance with Article XVII standards. This legal framework, when taken together with other aspects of the CWB export regime, is inconsistent with Article XVII.

(b) What is the United States' claim with respect to "the provision to the CWB of exclusive and special privileges"? Paras. 3 and 50 of the US first written submission appear to recognize that Members may provide exclusive or special privileges to enterprises.

2. Article XVII is premised on the fact that Members can grant exclusive and special privileges to STEs. However, in recognition of the fact that these benefits and privileges may enable STEs to engage in trade-distorting practices to the detriment of other Members, Article XVII imposes specific obligations on Members that establish STEs. The United States alleges that the CWB export regime as a whole, including the actions of the CWB resulting from the unchecked exercise of its exclusive and special privileges, violates Canada's obligations by necessarily resulting in the CWB making sales that are not in accordance with the standards set forth in Article XVII:1.

(c) What "actions" of Canada with respect to the CWB's purchases and sales involving wheat exports are inconsistent with Article XVII:1?

3. The "actions" of the Government of Canada that affect the purchases and sales of wheat are: (1) Canada's failure to exercise its authority to oversee the CWB, (2) Canada's approval of the CWB's borrowing plan and guarantees of all borrowings as well as credit sales, and (3) Canada's

approval and guarantee of the initial payment price. These actions, when taken together with other aspects of the CWB export regime, are inconsistent with Article XVII.

(d) What "actions" of the CWB with respect to the CWB's purchases and sales involving wheat exports are inconsistent with Article XVII:1?

4. The "actions" of the CWB are the CWB's purchases and sales of wheat on discriminatory and non-commercial terms.

Q2. In connection with the US argument that Canada is required under Article XVII:1 to "ensure" that the CWB meets the Article XVII:1 standards, please provide clarification as follows:

(a) Is the United States arguing that Canada's legislation must require, or mandate, the CWB to meet the Article XVII:1 standards? (US first written submission, paras. 65-66)?

5. No, the United States is not arguing that statutory language requiring the CWB to meet Article XVII:1 standards would be sufficient to meet Canada's obligations under Article XVII. In any case, it is undisputed that Canada has no such statutory provision in place. We understand that, as a general matter, Members may choose the mechanism that they wish to use to meet their WTO obligations. In this case, because the CWB's legal structure and incentives, absent any countervailing supervision or incentives, necessarily results in the CWB making sales not in accordance with the Article XVII standards, Canada is not meeting its WTO obligations.

(b) Is the United States arguing that in addition to imposing a statutory requirement on the CWB that it meet the Article XVII:1 standards, Canada would need to supervise CWB operations? (US first written submission, para. 69 and footnote 59) Or is the supervision requirement an alternative to a statutory requirement?

6. While this question sets forth possible means for Canada to bring itself into compliance with Article XVII, it is undisputed that Canada is not now undertaking such supervision, in accordance with a statute or otherwise. This absence of supervision, taken together with the legal structure of the CWB and the incentives created by the CWB export regime, is not consistent with the Canada's obligations under Article XVII.

(c) Regarding the supervision requirement, what level and what kind of government supervision would be required to "ensure" compliance with the Article XVII:1 standards?

7. It would not be appropriate for us to speculate as to whether any particular measures adopted by Canada would bring the CWB export regime into compliance. Whether any particular, hypothetical level of supervision by Canada would actually lead to a conclusion that Canada was in compliance with its obligations under Article XVII would depend on all of the facts and circumstances of the CWB export regime as a whole. The fact that Canada is undertaking *no* such supervision at present, in combination with other aspects of the CWB export regime, is sufficient to conclude that the regime is inconsistent with Article XVII.

(d) Is Article 18 of the CWB Act insufficient to meet the supervision requirement argued for by the United States?

8. Yes. In this case, Canada has explained that while it could supervise the CWB under Article 18, it chooses not to do so. That fact of non-supervision, in combination with the other aspects of the CWB export regime established by Canada, means that Canada has failed to meet its obligations under Article XVII.

(e) Is the United States arguing that as long as an STE has the ability to engage in conduct proscribed by Article XVII:1, the Member maintaining or establishing it is in breach of Article XVII:1, or is the United States arguing that as long as an STE has this ability, the Member concerned is under an obligation to supervise the STE's operations? (US first written submission, paras. 67, 77-78)

9. Neither one of these statements captures the US position. It is not the mere fact that the CWB has the ability to engage in conduct proscribed by Article XVII:1 that results in a breach of Article XVII. Rather, the CWB's unique legal structure and incentives, and the lack of any countervailing supervision or incentives, necessarily result in the CWB making sales not in accordance with Article XVII standards. A lack of government supervision is but one element of the CWB regime. If this element, or any other element, were to be modified, the WTO-consistency of the CWB regime would need to be reevaluated.

(f) With reference to para. 50 of the US first written submission, why cannot the balance of rights and obligations be preserved by an interpretation of Article XVII:1 according to which, under Article XVII:1, Members have the right to establish and maintain trading enterprises with special or exclusive privileges, but in exchange must do nothing more than assume responsibility under international law for any conduct by such enterprises which has been found not to be in accordance with certain prescribed standards?

10. It is not entirely clear to us what it would mean, in the context of the WTO Agreement, for Canada to "assume responsibility under international law" if Canada did not, as suggested in paragraph 50 of the first US submission, "ensure that the STE acts in a manner consistent with the general principles of non-discriminatory treatment, to make purchases or sales solely in accordance with commercial considerations, and to allow the enterprises of other Members an adequate opportunity to compete." As described before, in the absence of supervision by the Government of Canada and given its unique structure, the CWB export regime necessarily results in the CWB making sales not in accordance with Article XVII standards. The CWB regime is therefore inconsistent with Article XVII. In these circumstances, Canada cannot be said to have assumed its responsibility under the WTO Agreement.

Q3. Is the United States arguing that if the CWB used its privileges to make sales on terms which could not or would not normally be offered by privately-held marketing agencies, such sales necessarily would not be in accordance with "commercial considerations"?

11. Yes. This is supported by the provision in Article XVII:1(b) concerning allowing enterprises of other Members an adequate opportunity to compete.

Questions Posed to Both Parties

Q6. Do the "commercial considerations" referred to in Article XVII:1(b) vary depending on what type of entity (e.g., co-operatives, share-capital corporations, etc.) is conducting the purchase or sales operations?

12. No. Commercial entities, whether cooperatives or share-capital corporations, make decisions in an environment that is constrained by market forces. These market forces discipline commercial

entities regardless of their corporate structure. The CWB is not disciplined by market forces in the same way that commercial enterprises are. For example, a commercial cooperative enterprise has to compete for farmer members, and farmers are free to leave a cooperative and sell their wheat elsewhere if the commercial cooperative does not provide favourable returns. A share-capital corporation must also compete in the marketplace for sales of wheat and must balance commercial risks when making a decision regarding how much the corporation can pay for wheat. Unlike any commercial enterprise disciplined by market forces, the CWB has a guaranteed supply of wheat because farmers have no viable alternative but to sell their wheat for domestic human consumption and export to the CWB. This guaranteed supply of wheat gives the CWB a different risk and pricing structure than a commercial actor.

Q7. Please indicate whether, in your view, the CWB is a "State enterprise" or an "enterprise" which has been granted "exclusive or special privileges", as these terms are used in Article XVII:1(a), and why.

13. We consider the CWB to be a state trading enterprise, as Canada acknowledges in its STE notification.¹

Questions Posed to the United States

Q8. Could the United States confirm that, in respect of receipt of foreign grain into Canadian elevators, the United States' claim is that the provisions of section 57 of the Canada Grain Act, as such, are inconsistent with Article III:4 of the GATT 1994?

14. Yes, section 57 of the Canada Grain Act, as such, is inconsistent with Article III:4.

Q9. Could the United States confirm that, in respect of the mixing of grain, the United States claim is that the amended provisions of section 56(1) of the Canada Grain Regulations (Exhibit CDA-23), as such, are inconsistent with Article III:4 of the GATT 1994?

15. Our first submission addresses the measure in effect at the establishment of the March Panel and the July Panel, which is section 56(1) prior to amendment. This measure, as such, is inconsistent with Article III:4. The amended provision, although not within the terms of reference of the Panel, also appears to do exactly the same thing, since, as we understand, US grain cannot qualify as eastern Canadian grain. Accordingly, the amended measure, as such, also appears to be inconsistent with Article III:4.

Q10. Could the United States indicate whether, in respect of the revenue cap, the United States claim is that the provisions of section 150(1) of the Canada Transportation Act, as such, are inconsistent with Article III:4 of the GATT 1994?

16. The US claim is that section 150(1) and section 150(2) of the Canada Transportation Act, as such, are inconsistent with Article III:4.²

Q11. Could the United States confirm that, in respect of rail car allocation, the United States claim is that the provisions of section 87 of the Canada Grain Act, as such, are inconsistent with Article III:4 of the GATT 1994?

¹ See Working Party on State Trading Enterprises, New and Full Notification [by Canada] Pursuant to Article XVII:4(a) of the GATT and Paragraph 1 of the Understanding on the Interpretation of Article XVII, G/STR/N/4/CAN, 5 November 2002 (Exhibit US-1).

² See First Written Submission of the United States, para. 45.

17. Section 87 of the Canada Grain Act is inconsistent with Article III:4. Canada's claim that foreign producers may use producer rail cars under section 87 is a hollow one. Only Canadian producers can take advantage of producer rail cars under section 87 because all producer car loading stations are in Alberta, British Columbia, Manitoba, or Saskatchewan.

Questions Posed to Both Parties

Q20. Once a panel has determined that, in making certain export sale(s), an STE did not act in conformity with the standards set forth in Article XVII:1(b), can the panel find a violation of Article XVII:1 on that basis alone, or is it necessary for the panel to make a separate and additional determination whether, in making the export sale(s) in question, the relevant STE did not act in a manner consistent with the general principles of non-discriminatory treatment

18. Article XVII:1(b) states that the obligations under Article XVII:1(a) "shall be understood to require" that STEs make purchases and sales in accordance with commercial considerations and afford the enterprises of other Members adequate opportunity to compete in accordance with customary business practice. Thus, Article XVII:1(b) sets forth examples of conduct that Article XVII:1(a) requires. To fail to engage in the required conduct under Article XVII:1(b) constitutes a violation of XVII:1. As the *Korea Beef* panel found, "[a] conclusion that the principle of non-discrimination was violated would suffice to prove a violation of Article XVII; similarly, a conclusion that a decision to purchase or buy was not based on 'commercial considerations,' would also suffice to show a violation of Article XVII."³

19. Moreover, on the facts of this case, a finding that the CWB makes sales not in accordance with commercial considerations under Article XVII:1(b) necessarily leads to the conclusion the CWB is not acting in accordance with the general principles of non-discriminatory treatment. Under the CWB's statutory structure and incentives, it uses its pricing flexibility to make sales on non-commercial terms in order to target particular export markets, resulting in a violation of general principles of non-discriminatory treatment.

Q21. The second clause of Article XVII:1(b) requires STEs to afford enterprises of other Members adequate opportunity "to compete for participation in such purchases or sales".

- (a) **Is the expression "such purchases or sales" a reference to a given STE's "purchases or sales involving either imports or exports", i.e., the expression used in Article XVII:1(a)? In other words, is "such purchases" a reference to a given STE's purchases abroad (imports) and "such sales" a reference to a given STE's sales abroad (exports)?**

20. In the context of this case, the expression "such purchases or sales" in the second clause of Article XVII:1(b) refers to the opportunity to participate in the CWB's sales of wheat. This is more fully explained in the answer to question 21(b), below.

- (b) **Taking the case of an export STE like the CWB, are the relevant "enterprises" of other Members (i) the enterprises which are interested in buying wheat from the CWB (i.e., wheat buyers); (ii) those enterprises competing with the CWB for sales to the same wheat buyers (i.e., wheat sellers) or (iii) other enterprises?**

21. Under Article XVII, an STE has an obligation to afford all enterprises an adequate opportunity to compete for *participation* in its purchases or sales involving either imports or exports.

³ *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, (WT/DS161/RWT/DS169/R) (31 July 2000) (hereinafter *Korea Beef*), para. 757.

This, in addition to the first obligation under Article XVII:1(b) to act in accordance with commercial considerations, obliges a Member to ensure that its STEs with special and exclusive benefits and privileges act as commercial actors. Here, the enterprises at issue would include any enterprise that is competing for participation in CWB wheat sales, including enterprises competing to purchase wheat from the CWB (i.e., wheat buyers), as well as those enterprises selling wheat in the same market as the CWB (i.e., wheat sellers).

Q22. Assume a Member has an export STE which has the exclusive right to sell a particular agricultural product for export and domestic consumption. Please indicate whether in the following situations the STE would be making its export sales in accordance with "commercial considerations" within the meaning of Article XVII:1(b):

- (a) The STE charges a lower price in export market 2 than in export market 1 because market 2 is contested by a supplier who benefits from an export subsidy, while market 1 is not.**

22. We assume for this question that the STE and the subsidized supplier are offering wheat for sale on the same terms, with the exception of price. We also assume that to meet the subsidized price, the STE would be offering wheat for sale at a price that is less than the replacement value for the wheat. Although in the short run both a private supplier and an STE could sell below cost in this manner to meet the subsidized price in export market 2, in the long run a private actor could not sustain this behaviour. If an STE uses its special and exclusive privileges to engage in sustained, long-run price discrimination between export market 2 and export market 1 in these circumstances, the STE is not acting in accordance with commercial considerations.

23. A Member is not permitted to violate its obligations under Article XVII of the GATT 1994 merely because that Member's STE sells in a market where its competitor has received export subsidies. No such exception exists under Article XVII. Price discrimination by an STE using its exclusive and special privileges in a non-commercial, non-transparent manner is not permitted under Article XVII.

- (b) The STE charges a lower price in export market 2 than in export market 1 because market 2 is a priority market for the STE (e.g., due to expected growth in import demand) and the lower price is intended to deter other exporters from contesting export market 2. The price charged by the STE in export market 2 would not or could not have been charged in the absence of the special or exclusive privileges enjoyed by the STE.**

24. In this case, the STE would not be making its sales in accordance with commercial considerations because it could not price discriminate in export market 2 in the absence of its special and exclusive privileges.

- (c) The STE charges a higher price in export market 1 than in export market 2 because the price-elasticity of import demand is lower in export market 1 than in export market 2.**

25. In this case, assuming that both the STE and a private seller without any special and exclusive privileges could both sell at a higher price in export market 1 due to the price-elasticity of import demand, the STE would be acting in accordance with commercial considerations. However, if the STE alone was able to engage in price discrimination in this manner due to its exercise of special and exclusive privileges, the STE would not be acting in accordance with commercial considerations.

- (d) **Same as (c), but the STE in addition extracts monopoly rents (price premiums) in both markets, which it could not do but for its exclusive right to export the product concerned (assume the STE's product is perceived as superior in quality for instance, such that there is no significant competition from other products).**

26. An STE that extracts monopoly rents in both markets, which it could not do but for its special and exclusive benefits and privileges, is not acting according to commercial considerations. Although a commercial actor may be able to extract some monopoly rents if it faces little competition in the marketplace, the fact that an STE is able to use its special and exclusive benefits and privileges to extract monopoly rents in markets regardless of the price elasticity of demand means that the STE is not acting in accordance with commercial considerations.

Q23. Is the "commercial considerations" requirement in Article XVII:1(b) essentially intended to make sure that STEs use their special or exclusive privileges in such a way that their purchases or sales involving imports or exports are made on terms which are no more advantageous for the STE than they would have been if the STE did not have any special or exclusive privileges? Or is the "commercial considerations" requirement essentially intended to make sure that STEs act like rational economic operators, i.e., that, in their purchase or sale decisions, they are guided only by the consideration of their own economic interest?

27. Article XVII:1(b) requires STEs to act *commercially*, not merely rationally. Therefore the "commercial considerations" requirement in Article XVII:1(b) is intended to ensure that STEs do not use their special privileges to the disadvantage of commercial actors. A Member could not meet the second obligation under Article XVII:1(b) – to afford enterprises of other Members adequate opportunity to compete – if an STE's special privileges could be used to gain special advantages in the marketplace. Article XVII:1(b) must be read in its entirety, and the first obligation under XVII:1(b) cannot render moot the second obligation under Article XVII:1(b). These two obligations must be read together. Therefore, the "commercial considerations" requirement in Article XVII:1(b) must be intended to ensure that commercial enterprises without special and exclusive privileges are able to adequately compete for participation in the STE's purchases and sales involving imports and exports.

Q24. Pursuant to Article XVII:1(a), each Member undertakes that its STEs "shall" act in a specified manner. Please explain the meaning and usage of the term "shall" in Article XVII:1(a). In particular, what, if any, difference in meaning would there be if Article XVII:1(a) had said that each Member "undertakes" that its STEs "will" act in the specified manner?

28. Here the term "shall" should be given its ordinary meaning. "Shall" implies an obligation. According to the New Shorter Oxford Dictionary, in relation to statutes, regulations, etc., "shall" is "equivalent to an imperative."⁴ Similarly, according to the Merriam-Webster Dictionary, "shall" is "used in laws, regulations, or directives to express what is mandatory."⁵ Simply put, the obligation of each Member under Article XVII:1(a) is a mandatory requirement that STEs granted special or exclusive privileges act according to the general principles of non-discriminatory treatment prescribed in the GATT 1994.

29. The language of Article XVII, as with many articles in the GATT 1994, sets forth obligations using the term "shall." The United States cannot address how different language not found in Article XVII might or might not change the nature of the obligations at issue in this case.

⁴ New Shorter Oxford English Dictionary (1993), at 2808.

⁵ Merriam-Webster's Collegiate Dictionary: Tenth Edition (2001), at 1072.

Questions Posed to the United States

Q25. With reference to para. 58 of the US first written submission, please elaborate on how the Note to Articles XI, XII, XIII, XIV and XVIII supports the view that Article XVII:1(a) requires non-discrimination as between sales in the domestic market and sales in export markets.

30. The scope of the obligation under Article XVII:1(a) to “act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement” is a broad one. It does not refer to a specific article or specific obligation, but, rather, refers to the general principles of non-discrimination reflected in the obligations of the GATT 1994. This broad reference to non-discriminatory treatment would encompass discrimination between sales in the domestic market and sales in export markets.

31. Previous panels have concluded that the purpose of the Note to Articles XI, XII, XIII, XIV and XVIII of the GATT 1994 “is to extend to state-trading the rules of the General Agreement governing private trade and to ensure that the contracting parties cannot escape their obligations with respect to private trade by establishing state-trading operations.”⁶ Indeed, the *Korea Beef* panel found that the Ad Note’s broad purpose – to ensure that Members cannot escape their WTO obligations by establishing state-trading enterprises – led to the conclusion that the “general principles of non-discriminatory treatment” under Article XVII:1(a) must include national treatment, i.e., discrimination between imported and domestic products.

32. The same logic can be extended to export restrictions and the behaviour of a state export monopoly. Article XI generally states that no prohibitions or restrictions may be placed on exports. In other words, a Member may not withhold goods from export markets. The Ad Note makes clear that a Member cannot circumvent its obligations under Article XI by acting through a state-trading enterprise, thus establishing that the obligations of Article XVII:1(a) include non-discrimination between sales in the domestic market and sales in the export market.

Q26. With reference to paras. 17 and 65 of the US first written submission, is there anything in the CWB Act, or any other statute or regulation, which legally precludes the CWB from making its sales involving wheat exports in accordance with Article XVII:1?

33. The CWB is required by law to promote the sale of Canadian wheat in world markets. This statutory mandate and the actions of Canada and the CWB with respect to purchases and sales of wheat, along with the special and exclusive privileges granted to the CWB through laws and regulations, necessarily preclude the CWB from making sales in a non-discriminatory manner, according to commercial considerations, and in a manner that provides enterprises from other Members an adequate opportunity to compete. If the CWB were to act otherwise, it would violate its statutory mandate. Furthermore, Canada has not taken any steps to ensure that the CWB adheres to the Article XVII requirements.

Q27. Could the United States comment on the description of CWB export sale operations provided by Canada at paras. 54-58 of Canada's first written submission?

34. Paragraphs 54 through 58 do not provide any evidence that the CWB is acting in a non-discriminatory manner, is acting according to commercial considerations, or is allowing enterprises of other Members an opportunity to compete.

⁶ *Korea Beef*, para. 749 (quoting *Japan - Restrictions on Certain Agricultural Products* (L/6253-35S/163) (2 February 1988), para. 5.2.2.2).

35. The CWB states that it forecasts “target returns” for each export market in order to maximize overall return to the pool, but fails to explain what considerations are used when setting this target return. Similarly, while Canada states that managers are required to obtain a certain “acceptable return” on each sale, Canada does not provide any information on how this acceptable return is calculated. The CWB has an incentive to use its special and exclusive privileges to discriminate between foreign markets and make some sales in a non-commercial manner.

36. Finally, under paragraph 58, Canada states that “most,” but not all, sales prices are linked to US futures exchange prices and that the CWB “often,” but not always, looks to US exchanges to guide pricing decisions. The CWB also implicitly acknowledges that while differences in prices are “primarily” based on considerations such as grade and protein of grain and transportation costs, other, presumably non-commercial factors also come into play.

37. Indeed, paragraph 58 only tells part of the story, by focusing on Hard Red Spring wheat. Noticeably absent is any discussion of the Durum wheat market, even though the CWB accounts for over fifty per cent of world Durum exports. There is no futures market for Durum wheat, and commercial actors in the Durum wheat market have no basis upon which to judge the CWB’s Durum wheat prices.

Q28. With reference to para. 80 of the US first written submission, if the CWB tries to sell all wheat it has bought and in doing so seeks out the best markets and tries to obtain the best possible prices, are the sales made in this way in accordance with commercial considerations?

38. No. The CWB’s mandate under the CWB Act is to obtain “reasonable” prices, considering the objective of promoting sales of wheat. Accordingly, the CWB is driven to maximize sales quantity. In contrast, a commercial actor is only able to take advantage of a “best” price in a given market if that price covers the commercial actor’s replacement value for the wheat sold. The CWB’s special and exclusive privileges, including a government guarantee of all initial payments for wheat (which translates into a fixed, guaranteed, and known acquisition cost), means that the CWB does not need to obtain a price that covers its costs in every market. In addition, the CWB’s special and exclusive privileges allow the CWB to sell wheat at lower prices than commercial actors could ever offer.

Q29. With reference to section 7(1) of the CWB Act, is the "object of promoting the sales of grain produced in Canada in world markets" an objective which is commercial in nature? (US first written submission, para. 65)

39. Sales promotion is not *per se* inconsistent with commercial objectives. However, the objective of sales promotion is just one of many objectives a commercial enterprise would need to balance when acting in accordance with the realities and disciplines of the commercial marketplace. Canada has given the CWB special and exclusive privileges that can be used to promote sales without regard for other commercial considerations. With the Government of Canada guaranteeing CWB’s cost of acquisition of wheat (i.e., the initial payments made to farmers), the CWB can promote sales without being restrained by commercial considerations, thereby violating the obligations under Article XVII:1.

Q30. With reference to footnote 12 of the US first written submission, please provide support for the assertion that the CWB sets the "buy-back" price sufficiently high so as to make the "buy-back" programme commercially insignificant.

40. Under the CWB’s “buy-back” programme, wheat farmers who wish to export their wheat independently must both buy back their wheat from the CWB at a premium and receive an export license from the CWB to sell that wheat abroad. The premium price is set by the CWB and is the

price the CWB determines the wheat farmer would get if selling in the foreign market for which the export license is issued. This means that the wheat farmer must pay the CWB not only for the cost of the wheat, but also for the expected return that wheat will earn when sold in a foreign market. The CWB sets this artificial price, and it is not based on any publicly available rate.

41. Section 46(d) of the CWB Act provides for the “buy-back” programme. That provision states, in relevant part, that the “buy-back” programme requires:

recovery from the [farmer] by the [CWB] . . . of a sum that, in the opinion of the [CWB], represents the pecuniary benefit enuring to the [farmer] pursuant to the granting of a licence, arising solely by reason of the prohibition of exports of wheat and wheat products and then existing differences between prices of wheat and wheat products inside and outside of Canada.

42. The only farmers who participate in the buy-back programme are those who think they can sell their wheat for an artificial price above the price the CWB determines that farmers should earn abroad. It is not surprising that few, if any farmers, choose to accept this risk. Effectively, the CWB has used its special and exclusive privileges to negate any benefit a farmer might be able to receive through the independent sale of his wheat in foreign markets. A similar buy-back programme is available for independent wheat sales to the domestic market for human consumption.

Q31. The United States asserts that on average the CWB's initial payment to farmers has been between 65 and 75 per cent of the expected final value of the wheat sold (US first written submission, para. 25). Does the United States argue that any marketing arrangement which involves an initial payment plus a revenue-sharing arrangement is necessarily inconsistent with commercial behaviour? If not, please indicate what would be a "commercial" initial payment (as a percentage of the expected final value of the wheat sold), taking account of the marketing and other services provided under such a marketing arrangement.

43. Marketing arrangements that involve an initial payment are not per se inconsistent with commercial behaviour. However, the CWB is afforded the special and exclusive privileges that enable the CWB to use pooling in a manner that is inconsistent with commercial considerations. The Government of Canada guarantees the CWB's initial payment price and effectively requires farmers to sell their wheat to the CWB, giving the CWB greater pricing flexibility than a commercial actor would have. The CWB's decision to set its initial payment price is not governed by commercial considerations since the Government of Canada's guarantee of those payments ensures that any potential pool deficits are covered and farmers cannot opt out of the CWB regime without facing significant costs. In other words, the CWB is not governed by the commercial reality of facing an actual economic loss on sales or of losing its source of supply. No commercial actor can determine its purchase price for wheat knowing that the purchase price will not affect the commercial entity's bottom line. The Government of Canada removes market risk from the CWB's decision to procure wheat.

Q32. With reference to para. 25 of the US first written submission, please explain further how the fact that the initial price is set by the CWB and the Government of Canada, as distinct from possible government guarantees of the initial payments, gives the CWB greater pricing flexibility than other grain trading companies.

44. A commercial actor does not face a guaranteed supply of wheat at a known, fixed price of acquisition throughout the marketing year. The only way for a commercial actor to obtain such a price guarantee is to purchase futures or options to ensure against price fluctuations. Price certainty gives the CWB greater pricing flexibility than other grain trading companies because the CWB faces a completely different price risk structure that is not driven by commercial considerations. A private

grain company would have to pay a tangible cost to obtain the same certainty under commercial conditions.

Q33. Please provide evidence supporting the existence of the two alleged pool deficits (US first written submission, para. 26). Were these two deficits paid for by the Canadian government?

45. Exhibit US-16 includes relevant pages of CWB Annual Reports which document two pool deficits.⁷ These two pool deficits were paid for by the Government of Canada.⁸

Q34. The United States has stated that when the CWB makes a sale on credit, the credit is extended at a commercial rate (US first written submission, para. 36). At the same time, the United States has stated that government guarantees of CWB borrowings allow the CWB to provide more favourable credit terms than those provided by commercial grain traders (US first written submission, para. 75). Please explain how these statements can be reconciled.

46. The CWB, benefiting from its special and exclusive privileges, has an opportunity to offer credit terms that are far more favourable than those offered by commercial grain sellers who do not benefit from guaranteed government borrowing at below-market rates. The CWB can take greater risks in extending credit than a commercial grain trader because the CWB is getting *its* financing at below commercial rates. In paragraph 75, the United States observes that all other terms being equal, as a direct result of the CWB's special and exclusive borrowing privileges, the CWB will be able to capture a sale by taking a greater credit risk than would be warranted if the CWB was acting under the commercial considerations of a private grain trader. When the CWB extends credit at commercial interest rates, it can take additional credit risks, such as offering a longer term for the loan than would be offered by a commercial actor. This has the effect of denying enterprises of other Members an adequate opportunity to compete, since a private grain trader acting according to commercial considerations and without the special and exclusive privileges of the CWB would not be able to make the sale on the same terms.

47. It should be noted that the CWB also has an arbitrage opportunity as a direct result of its government-guaranteed borrowing privileges. We do not mean to imply that the CWB never seizes upon this opportunity. Indeed, if the CWB lends at commercial rates and borrows at below commercial rates, it profits from interest rate arbitrage in a way that a commercial enterprise of another Member, acting according to customary business practice, could not.

Q35. The United States argues that because the CWB is required to sell all Western Canadian wheat which is produced, it will tend to export larger quantities of wheat at a lower price than would a competitive marketing structure. But if Canadian wheat production were to decrease because the CWB returns a lower price to Canadian farmers than would a competitive marketing structure, can the United States produce any evidence, in theory or otherwise, and in addition to Exhibit US-15, that CWB export supplies over time would be higher with the current marketing structure?

48. In accordance with its legislative mandate, the CWB attempts to maximize all sales of Western Canadian wheat produced in a current marketing year. Through its special privileges the CWB has more pricing flexibility than a commercial entity and can reduce prices in order to export larger quantities of wheat.

⁷ See Canada Wheat Board, Annual Report: 1985-86, pp. 46-47; Canada Wheat Board, Annual Report: 1990-91, Table A. (Exhibit US-16.)

⁸ *Id.*

49. Since farmers cannot, in practice, privately sell their wheat for domestic human consumption or export without going through the CWB, the fact that some may believe they could receive a higher return through a more competitive marketing structure does not factor heavily into the determination to produce wheat. There is effectively no exit option, as demonstrated by the Western Canadian wheat farmers that have gone to jail for attempting to market their wheat on their own, outside of the costly buy-back programme that effectively precludes farmers from operating outside of the CWB's marketing structure.

50. If some farmers did reduce their wheat production, the CWB would still continue to have access to practically all wheat produced in Western Canada because of the CWB's monopsony privilege and thus would always have a relatively stable supply of high quality wheat for sale. Indeed, the CWB has paid farmers a premium for high quality wheat even when such a premium is not justified by demand, giving Western Canadian farmers an incentive to over-produce high quality wheat. **A CWB and Manitoba Rural Adaptation Council Inc. study (Exhibit US-15) found that during the base period (1992-1997),** on average, the production of high quality Canadian Red Spring Wheat exceeded the market demand that has been willing to pay a commercial price premium for wheat of that quality. In particular, the analysis suggests that Canadian high-quality wheat production exceeded demand by 32 per cent over 1992-1997. Western Canadian wheat farmers respond to the realities of the CWB-dominated wheat market and, with no alternative marketing structure available, continue to produce and sell wheat to the CWB of a quality and in a quantity that is responsive to the CWB rather than to market demand.

Questions Posed to Both Parties

Q42. As a supplement to Exhibit CDA-24, could the parties provide an estimate of the volume and proportion of US grain imported into Canada for domestic consumption as compared to that imported for re-export?

51. Attached as Exhibit US-17 is information on total US grain shipments to Canada. The United States does not collect data on Canadian use of US grain and therefore is unable to provide an estimate of the proportion of US grain imported for domestic consumption or re-export.

Q43. Are the findings at para. 11.169 of the panel report on Argentina - Hides and Leather *mutatis mutandis* and at paras. 8.133-8.134 of the panel report on US - FSC (Article 21.5 - EC) relevant to this Panel's assessment of whether the grain segregation and rail transportation measures give rise to differential treatment as between "like" products within the meaning of Article III:4 of the GATT 1994?

52. The reasoning in both reports is relevant. The panel in *US – FSC (Article 21.5 - EC)* explicitly found that a good is not “unlike” merely because of its origin. The panel went on to find that for measures of general application, “there is no need to demonstrate the existence of actually traded like products in order to establish a violation of Article III:4.” US origin grain, even when of the exact same type as domestic Canadian grain, is subject to differential treatment as “foreign grain” under Canada's grain segregation and transportation measures. Because origin alone cannot serve as a basis for a determination that two commodities are not like products, Canada's challenge that US grain is not “like” Canada origin grain fails.

53. Regarding the reasoning in *Argentina - Hides and Leather*, that panel found that where the structure and design of the measure at issue differentiates among products based not on physical characteristics or end-uses but, instead, based on factors which are not relevant to the definition of likeness, the evidence required for a party to discharge its burden of establishing that a measure applies to products is minimal. And, as the *FSC* panel noted, product origin cannot serve as a basis for a determination that two products are not “like.” Here, because Canada's grain segregation and

rail transportation measures discriminate on the basis of origin – even when all other product characteristics are exactly the same – one must reach the conclusion that the measure at issue applies to like domestic and foreign products. Thus, the structure and design of the Canadian measures alone make clear that like products are subject to the Canadian measures at issue.

Q44. Are all imported and domestic products falling within each of the categories of "grains" as defined in section 5(1) of the Canada Grain Regulations "like products" for the purposes of Article III:4 of the GATT 1994, or are there different "like" products within each of the categories of grain? Are all imported and domestic products falling within each of the categories of "grains" or "crops" as defined in section 147 of the Canada Transportation Act "like products" for the purposes of Article III:4 of the GATT 1994, or are there different "like" products within each of the grain or crop categories?

54. All imported and domestic products falling within each of the categories of “grains” as defined in section 5(1) of the Canada Grain Regulations are “like products” for the purposes of Article III:4 (i.e. foreign durum wheat and Canadian durum wheat, foreign canola and Canadian canola, foreign barley and Canadian barley).

55. The same holds true for like products falling within each of the categories of “grains” or “crops” as defined in section 147 of the Canada Transportation Act.

Q45. Could the parties respond to the EC's assertion in paragraph 43 of its third party written submission that a bulk grain handling system, such as that covered by the Canada Grain Act, "offers cost advantages compared to other ad hoc distribution possibilities."

56. The EC’s assertion that a bulk grain handling system, such as that covered by the Canada Grain Act “offers cost advantages compared to other ad hoc distribution possibilities” must be viewed in the context of the entire paragraph of the EC submission, paragraph 43, which states:

In contrast, the fact evoked by Canada that foreign producers are not obligated to use Canadian grain elevators, and may for instance deliver directly to Canadian end users does not remove the unfavourable effects of the entry into grain elevators. It must be presumed that an efficient bulk grain handling system offers cost advantages compared to other ad hoc distribution possibilities. Equally, the fact that an exceptional authorization for using the elevators is a “well known and used” process does not remove the less favourable treatment of foreign grain.

57. We believe that the key phrase in this paragraph is that the possibility of alternative distribution channels or exceptional authorizations “does not remove the less favourable treatment of foreign grain.” Canadian grain can move in and out of the bulk grain handling system subject to far less burdensome regulatory requirements than foreign grain. If foreign grain was treated as favourably as like Canadian grain in the bulk handling system, foreign grain could be transported at far less cost.

58. There is a reason that the vast majority of grain in Canada travels through the bulk grain handling system – there is no efficient alternative for most grain producers. The majority of grain in the market is sold to large-quantity purchasers whose demands cannot be met by individual farmers shipping small lots of grain directly to end users outside of the bulk grain handling system. The bulk grain handling system allows numerous grain farmers to consolidate smaller quantities of grain at elevators into the large bulk shipments that purchasers demand. Farmers who cannot take advantage of the bulk grain handling system face prohibitive handling and transportation costs. For example, trucking rates are significantly higher than rail rates and are not a viable economic alternative for most

producers. It is difficult and costly to access the rail system as an individual producer, rather than through the bulk handling system.

Questions Posed to the United States

Q46. With reference to paras. 207, 217 and 279 of Canada's first written submission, is it correct that Article III:4 of the GATT 1994 does not apply to laws affecting the transportation of goods in-transit?

59. There is no question that Article III applies to the measures at issue in this case. Canada's references to Article V of the GATT 1994 and in transit shipments are no relevant to this dispute. The laws and regulations at issue in this case – the Canada Grain Act and the Canada Grain Regulations – are measures affecting the internal transportation and distribution of grain. These measures affect all foreign and domestic grain that arrives at a bulk handling facility. Any foreign grain or domestic grain entering Canada's bulk grain handling system is subject to Canada's internal grain regulation from the moment that grain arrives at an elevator in Canada, regardless of the final destination of the product.

60. There is a limited scenario in which US grain is truly "in transit" through Canada and is not subject to Canada's internal regulatory process. US grain shipped from the US State of Montana by rail on sealed rail cars that travel through Canada and do not stop until they reach their final destination in the US State of Washington are not subject to Canada's internal measures because that grain never enters the Canadian grain handling system. Any Canadian regulations in connection with such traffic in transit are not at issue in this case.

Q47. With reference to para. 91 of the US first written submission, please explain how section 57 of the Canada Grain Act and section 56 of the Canada Grain Regulations affect the "transportation" of grain.

61. Canada's bulk grain handling system is the internal distribution and transport network for grain in Canada. The Canada Grain Act and the Canada Grain Regulations comprise the regulatory structure for the bulk grain handling system, including the receipt and treatment of grains by elevators throughout Canada. Most grain transported internally in Canada will, at some point, be received and/or stored in a Canadian grain elevator. The language in the two passages referenced in the Canada Grain Act and Canada Grain Regulations state that Canadian elevators must not receive foreign grain, except as authorized, and must not mix foreign grain with Canadian grain. Since elevators comprise the main transport and distribution network for grains, these regulations necessarily affect both the transportation and distribution of grain.

Q48. What is the United States' reaction to the assertion by Canada in its first written submission (para. 238) that "since the entry into force of the WTO Agreement, the CGC has never refused entry of foreign grain into Canadian elevators"?

62. The issue in this dispute is not whether the CGC has refused entry of foreign grain into Canadian grain elevators. The regulations administered by the CGC result in less favourable treatment for foreign grain than for like domestic grain. The CGC may grant licenses, but these licenses are conditionally granted and require elevators to satisfy additional onerous regulatory requirements that are not imposed on like domestic grain.

Q49. Could the United States submit a complete version of the Canada Transportation Act (Exhibit US-9)?

63. A complete version is attached as Exhibit US-18.

Q50. Does the United States agree with Canada's assertion, at para. 282 of its first written submission, that the only rail movements subject to the revenue cap which affect transportation of imported grain for internal sale are the movements of imported grain to Thunder Bay or Armstrong for domestic use in Canada?

64. The United States fundamentally disagrees with Canada's assertion that the only relevant rail movements are movements of US-origin grain to Thunder Bay or Armstrong for domestic use in Canada. As stated in Canada's own submission, the revenue cap applies to all grain movements that "originate in Western Canada."⁹ Thus, the revenue cap applies to the internal transport of all grain within Canada from points in Western Canada to other Canadian ports. All of these movements are covered by Article III:4.

Q51. With reference to para. 100 of the US first written submission:

(a) Could the United States explain how the revenue cap translates into a competitive advantage for Western Canadian grain over imported grain in respect of the internal transportation of grain?

65. Because railroads must pay a significant penalty for exceeding the rail revenue cap, railroads price transport for Western Canadian grain subject to the cap at rates below the level that could trigger the railroad to exceed the cap. Rail rates charged for imported grain can be set at a level that exceeds the rail rates charged for domestic grain because the revenue cap does not apply to shipments of foreign grain.

(b) Why does the revenue cap necessarily constrain the rate-setting of the prescribed railways rather than the volume of grain shipped?

66. Revenue received per mile is likely far more predictable than volume hauled. Because of the CWB's secrecy, railroads are faced with a great deal of uncertainty regarding the volume of commodities to be moved, as well as the timing and demand for rail equipment during the marketing year. We understand that the railroads have never denied transport of Board grain. As the railroads have little control over volume, rates are set at a low enough level so that adjustments can be made if concerns arise about annual revenues, and there is ample opportunity to raise rates without exceeding the revenue cap.

(c) Could the United States explain how a system which appears to mandate a maximum average rate translates into a competitive advantage for Western Canadian grain?

67. For an explanation of how the rail revenue cap translates into a competitive advantage for Western Canadian grain, please see the US answer to question 51(a).

Q52. Could the United States comment on paras. 290 and 291 of Canada's first written submission?

68. Paragraphs 290 and 291 discuss grain movements that contain a transportation segment that is not subject to the revenue cap for domestic movements of grain. However, Canada ignores cases where the revenue cap applies for the full route, i.e. shipments westward for export or shipments eastward that stop at Thunderbay. Whether the rail revenue cap applies to part of the route or the full route, railroads provide lower rates to Western Canadian grain shipments subject to the cap so that the

⁹ Canada First Submission, para. 269.

railroads do not pay the penalty for exceeding the cap. As a practical matter, therefore, the rail revenue caps keep prices lower for the transport of Western Canadian grain. Shipments of Western Canadian grain that are subject to the rail revenue cap pay lower transportation costs than those shipments would pay without the revenue cap. These lower transportation costs accord domestic grain more favourable treatment than like foreign grain.

69. Further, there is no support for Canada's argument in paragraphs 290 and 291 of its written submission that railroads can charge as high a rate for a non-regulated transportation segment and a low rate on the regulated transportation segment so that the average rate reflects a "market" rate.

Q53. Could the United States confirm that, in respect of rail car allocation, the United States claim is that the provisions of section 87 of the Canada Grain Act, as such, are inconsistent with Article III:4 of the GATT 1994?

70. Yes, the United States claims that section 87 of the Canada Grain Act is inconsistent with Article III:4 of the GATT 1994.

Q54. With reference to para. 101 of its first written submission, could the United States explain how "[m]aking government rail cars available for the transport of domestic grain reduces transportation costs for any grain that receives this benefit."

71. The provision of railcars from the Government of Canada relieves the railroads of the costs of ownership associated with these rail cars. Therefore, the railroads can charge lower rates than would be the case if the railroads had to lease or purchase the railcars themselves and factor these additional costs into the freight rates. This cost savings is passed on to those transporting domestic grain under the producer car programme.

Q55. Could the United States explain further and provide further evidence for its assertion in paragraph 101 of its first written submission that the producer car programme "excludes all imported grain."

72. Despite Canada's statement to the contrary, foreign producers cannot take advantage of the producer rail car programme, as all of the loading sites are in Canada.¹⁰ In addition, the relevant regulations do not state that foreign grain is eligible for the producer rail car programme.

Q56. With respect to the United States' claims under the TRIMs Agreement, what specifically does the United States mean when it asserts in its first written submission (para. 103) that:

- (a) **The grain segregation requirements require elevator operators to "use" domestic Canadian grain; that the rail revenue cap requirements require shippers to "use" domestic Canadian grain; and that the producer car programme requirements require shippers to "use" domestic Canadian grain?**
- (b) **What precisely are the "requirements" the United States is challenging for each of the measures being challenged?**

¹⁰ See Canadian Pacific Railway, "CPR Producer Car Loading Sites," available at <http://www8.cpr.ca/cms/English/Customers/New+Customers/What+We+Ship/Grain/Producer+Cars.htm> (last visited 23 Sept. 2003) (Exhibit US-19); see also CN, "Producer Car Loader Station List," available at http://www.cn.ca/productsservices/grain/Canadaorigin/en_KFGrainCNProducerCarLoaderStationList.shtml (last visited 23 Sept. 2003) (Exhibit US-20).

(c) What "advantage" is the United States asserting the foreign shippers are seeking to obtain?

73. Answers to (a), (b) and (c) are discussed below for both elevator operators and shippers.

74. "Use" by elevator operators refers to handling of grain in the normal course of business, i.e., handling, storage and transport. The requirements challenged are the Canada Grain Act's prohibition on the receipt of foreign grain into grain elevators under section 57 and the Canada Grain Regulations prohibition on mixing foreign grains under section 56(1). Local content requirements can be facilitated through a variety of regulatory mechanisms, some of which are more transparent than others. Canada's prohibition on the receipt of foreign grain in elevators and prohibition on the mixing of foreign grain are "mandatory" and "enforceable" requirements within the meaning of the TRIMs Agreement Illustrative List. Moreover, they also provide direct cost advantages to those elevator operators that accept Canadian grain over foreign grain because the need for special authorization to accept and/or mix foreign grain and the onerous conditions that are often placed on such authorizations creates a regulatory regime that financially rewards those elevators that accept domestic grain over foreign grain. These matters are described in more detail in paragraphs 100 of the First Written Submission of the United States.

75. "Use" by shippers refers to the shipment of grain by rail. The requirements being challenged here are the requirement that only Canadian grain can be shipped in order to qualify for the rail revenue cap, and the requirement to ship Canadian grain in order to qualify for the producer car programme. Both requirements provide cost advantages in the form of lower rail transport rates to those shippers that choose to ship Canadian grain rather than foreign grain. Again, these matters are described in more detail in paragraph 101 of the First Written Submission of the United States.

Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain

LIST OF EXHIBITS

- US - 16. Canada Wheat Board, Annual Report: 1985-86, pp. 46-47; Canada Wheat Board, Annual Report: 1990-91, Table A.
- US - 17. USDA, Foreign Trade Statistics: Foreign Agricultural Service Export Commodity Aggregations for Canada: 1999-2003.
- US - 18. Canada Transportation Act, R.S.C., ch. 10 (1996).
- US - 19. Canadian Pacific Railway, "CPR Producer Car Loading Sites," *available at* <http://www8.cpr.ca/cms/English/Customers/New+Customers/What+We+Ship/Grain/Producer+Cars.htm>.
- US - 20. CN, "Producer Car Loader Station List," *available at* http://www.cn.ca/productsservices/grain/Canadaorigin/en_KFGrainCNProducerCarLoaderStationList.shtml.

ANNEX A-2

RESPONSES OF CANADA TO QUESTIONS POSED IN THE CONTEXT OF THE FIRST SUBSTANTIVE MEETING OF THE PANEL

(24 September 2003)

"CWB" stands for "Canadian Wheat Board".

"STE" stands for "State Trading Enterprise" and is intended to cover the type of enterprises covered by Article XVII.

Canada:

4. Canada appears to be saying that the CWB's sales should be compared to sales of a privately-held cooperative marketing agency (Canada's first written submission, para. 85 read together with para. 89). Privately-held enterprises do not normally enjoy privileges like those enjoyed by the CWB, however. Is Canada arguing that if the CWB used its privileges to make sales on terms which could not or would not normally be offered by privately-held marketing agencies, such sales would not be in accordance with "commercial considerations"?

1. "Exclusive or special privileges" by definition provide STEs with certain privileges (or advantages) that are either not enjoyed by other enterprises, or have a special character. The right of Members to grant such privileges implies necessarily a right on the part of the recipients of such privileges to use such privileges, including in their business activities. For example, if a Member has the right to grant to an enterprise an import monopoly, the recipient of such a monopoly privilege must also have the right to exercise and enjoy the advantage of having a monopoly in the market in which it has such an exclusive privilege.

2. Accordingly, the inquiry into whether an STE is acting consistently with Article XVII in its use of such privileges can only be undertaken by reference to a private sector entity with similar attributes. Otherwise, it would be impossible to determine whether the complained of behaviour was simply a reflection of the mere use of the privileges, which, in and of itself, is not prohibited, as opposed to the impermissible discriminatory conduct of an STE when using those privileges, which is prohibited.

3. The EC acknowledges this point at paragraph 13 of its Written Submission, where it states:

With regard to the obligations under subparagraph (b), the EC considers that the fact that a STE operates in its trade related activities on the basis of its special and exclusive commercial advantages does not *per se* prevent it from acting "in accordance with commercial considerations". This notion has to be interpreted in

light of a normal (private) commercial behaviour. Yet, it is clear that any private operator that benefits from special and exclusive rights would make use of them.

4. The question, therefore, would not be whether, in its purchases and sales, an STE acts commercially relative to any other enterprise that does not enjoy a similar privilege. Rather, the inquiry would concentrate on whether in making such purchases and sales, the STE acts as would a private enterprise that has the same rights and privileges. Because, after all, it is axiomatic that the use of a "privilege" implies some sort of competitive advantage relative to those that do not have such a privilege.

5. Finally, Canada notes that certain privately-held enterprises do enjoy privileges like those enjoyed by the CWB. For example, Cargill, a privately held US wheat trader, enjoys the privilege of utilizing US government export credit guarantee programmes (commonly known as GSM 102/103) to maintain or increase sales. Would the United States suggest that Cargill acts "non-commercially" every time it resorts to the lavish export credit guarantee programmes of the US government?

5. With reference to para. 29 of the US first written submission, what are the criteria for the approval by the Minister of Finance of the CWB annual borrowing plan? Please explain the approval process.

6. The CWB submits annually a borrowing plan for the Minister of Finance to approve as required under Section 19 of the *Canadian Wheat Board Act* (the "CWB Act"). The plan contains the details of the CWB's proposed borrowing programmes for the upcoming crop year.

7. In evaluating the borrowing plan, the Department of Finance officials examine:

- the level of borrowing in the plan as compared to previous years;
- the level of borrowing as compared to the CWB's forecasted needs related to credit receivables, grain purchases and spring and fall cash advances to producers under the cash advance programmes that the CWB administers on behalf of the Government of Canada;
- whether there have been any changes in the CWB's financing needs arising from the corporation's business activities; and
- whether the CWB's risk management framework is consistent with the Minister of Finance's Risk Management and Credit Policy Guidelines for Crown Corporations.

8. Once the borrowing plan is approved, the CWB must comply with the terms and conditions of the borrowing approval letter.¹ The Department of Finance does not approve individual borrowing transactions. The CWB must also comply with the Minister of Finance's reporting requirements in that it must report on its borrowing activity on a quarterly basis.

Both Parties:

6. Do the "commercial considerations" referred to in Article XVII:1(b) vary depending on what type of entity (e.g., Cooperatives, share-capital corporations, etc.) is conducting the purchase or sales operations?

¹ See Exhibit CDA-46 [contains strictly confidential information] for an example of a borrowing approval letter.

9. Commercial enterprises generally take into account similar factors in carrying out purchases or sales. These include the factors listed in Article XVII, namely “price, quality, availability, marketability, transportation and other conditions of purchase or sale.”

10. However, the way that each enterprise responds to such factors depends on the circumstances in which it operates. That is, the size of the enterprise, the market in which it operates, the type of organization that it is, its financial circumstances and any special or exclusive privileges that it may have been granted. For example, a large enterprise with significant assets may be willing to extend supplier credits that a smaller enterprise would not be able to extend because of the economic risks involved. Similarly, two banks of comparable size may have different risk exposures in their portfolios, thus encouraging one to lend to a market that the other would consider an inappropriate client. In both circumstances, each enterprise would be acting consistently with commercial considerations, even though the resulting conduct is opposite.

11. In this respect, Canada’s reference to the nature of the CWB as a “cooperative marketing agency” responded to unsupported US allegations contained in paragraphs 79-85 of its First Written Submission. There, the United States made a distinction between “profit-maximising” conduct by share-capital corporations and “revenue-maximising” conduct allegedly engaged in by the CWB. The United States made no attempt to explain why revenue-maximising is not “commercial conduct” – and indeed, any such attempt would be in vain. Even so, the US reference to “profit-maximising” on behalf of the corporation is, as Canada demonstrated and the United States failed to controvert, inapposite in respect of cooperatives and similar marketing agencies. As indeed the United States Department of Agriculture has observed, revenue maximising for a cooperative marketing agency translates into profit maximising for the farmer.

7. Please indicate whether, in your view, the CWB is a "State enterprise" or an "enterprise" which has been granted "exclusive or special privileges", as these terms are used in Article XVII:1(a), and why.

12. Article XVII does not provide a definition of a “state enterprise”. The Article covers “state enterprises” where a Member “establishes or maintains” one.

13. The CWB was established by an Act of Parliament, the *CWB Act*, which also sets out its corporate structure and powers. The CWB is a corporation without share capital and thus has no controlling shareholder. Until the end of 1998, the CWB was governed by a Board of Commissioners appointed by the government. The CWB was also an “agent of Her Majesty” and clearly was a “state enterprise” that had been granted exclusive or special privileges.

14. In 1998, the corporate structure of the CWB was altered so that its governance/is now vested in a Board of Directors, the majority of which are elected by farmers. As a result, the CWB is neither a Crown corporation nor an agent of Her Majesty.

15. Therefore, even if the CWB were not technically considered to be a “state enterprise” that has been granted exclusive or special privileges, Canada has no doubt that it would fall into the category of “any enterprise” that has been granted special or exclusive privileges. As a result, Canada has no doubt that it has responsibilities under Article XVII with respect to the CWB.

Canada:

12. Is the Panel correct in understanding that once a licensed elevator operator has been authorized to receive foreign grain, such grain can be mixed with Canadian grain of the same type and grade (and need not be identified as mixed grain), but that it cannot be mixed with

Canadian grain of a different type, or with Canadian grain of the same type but of a different grade, unless such mixing is authorised pursuant to relevant rules and regulations? Please refer to relevant legal provisions.

16. Canada is not concerned with the mixing of any given lot of grain with another lot of grain as long as the combined lot is not represented as “Canadian grain”. Canada’s concern is with uncontrolled mixing in the bulk grain handling system that would affect Canada’s ability to know the quality of the grain in the system, and its ability as an exporter to guarantee the quality, end-use characteristics and Canadian origin of the grain.

17. There is no legal provision that specifically regulates mixing of foreign grain with Canadian grain. If an elevator receiving foreign grain wants to mix that foreign grain with Canadian grain, it would make this request either together with the request for authorization to receive foreign grain, or at a later stage (Sections 57 and 72(2) of the *CGA*). The Canadian Grain Commission (“CGC”) would always authorize it, as long as the lot of mixed grain is identified as such to ensure that it is not misrepresented.²

18. As a general rule, elevator operators themselves will have no reason to mix different types of grain.

13. ⁽¹⁾ With respect to the authorisation of receipt of foreign grain into elevators pursuant to Section 57 of the *Canada Grain Act*:

(a) What is the process by which such orders are made by the Commission? How is the process initiated? How long does the process generally take? Does the process involve any documentary requirements, costs, etc.?

¹**Note:** Regarding Questions 13, 14 and 16, please provide documentary support for your answer.

19. The elevator operator initiates the process to obtain an authorization to receive foreign grain. It usually does so orally, by placing a telephone call to the CGC, and follows up with a written request. There is no form; the written request for authorization can be made by fax, e-mail, or post. The elevator operator informs the CGC of its intention to receive foreign grain and describes the type of grain, quality of the grain, origin and destination, and volume of the grain, as well as the anticipated date of receipt. Within a working day or two of the request, the CGC issues an order to the elevator authorizing the receipt of the grain. There are no costs involved. A request for authorization could cover several shipments.

20. Exhibits CDA-47 to CDA-53 [**all containing strictly confidential information**] contain examples of authorization requests by elevator operators, including requests covering several shipments and periods of several months, and orders issued by the CGC in response to these requests.

21. The process to obtain an authorization to receive foreign grain is routine, to the point that elevator operators may have already arranged the transport of the grain before making a request.

22. The elevator operators are very familiar with the process to obtain an authorization from the CGC to receive foreign grain. Elevator operators are in constant, and in most cases daily, communication with the CGC.

(b) What criteria are used to determine whether foreign grain should be received into elevators?

² For example, see Exhibit CDA-47 [contains strictly confidential information].

23. The authorization is routinely granted. The CGC, however, retains the authority to monitor and control shipments of foreign grain for certain problems, such as where the foreign grain contains a genetically modified grain not approved in Canada or where there is an SPS concern. In such cases, the authorization for entry of the foreign grain of concern may contain conditions to prevent it from contaminating grain in the elevator or the elevator equipment. Authorization would be denied only in very exceptional circumstances, where the imposition of these conditions would not be sufficient or where the risk of contamination would be too high.

(c) What would be the difference between the prescribed process and a notification system that entails completing a standardized form?

24. The existing authorization acts essentially like a notification. This is not an onerous process. A standardized form, especially one that would be required at the border, would complicate an existing informal, simple and flexible process and, would result in additional administrative costs for the importer in accordance with the provisions of GATT 1994 and the NAFTA. In addition, a simple notification would not allow the CGC to take appropriate measures where it became aware of certain SPS problems or other unforeseen problems such as the presence of genetically modified grain in the foreign grain that may affect the quality of Canadian grain in the handling system.

(d) Are there conditional requirements other than those referred to in footnote 118 of Canada's first written submission?

25. There may be a requirement that the foreign grain be identified on documents according to its origin and that the CGC be notified in respect of further movements of the foreign grain so that it can be tracked. In certain specific circumstances, certain conditions may be attached to an authorisation for an elevator to receive foreign grain in order not to compromise the quality of the grain within the bulk handling system. These may include the cleaning of equipment before and after delivery (for example if there were SPS concerns or in the case of shipments containing Starlink Corn) or CGC monitoring of receipt or discharge.

14. With reference to para. 224 of Canada's first written submission, how does Canada:

(a) keep track of domestically-produced grain entering the bulk handling system;

26. Elevators are required to report and account for all grain received and shipped (Sections 23-27 of the *Canada Grain Regulations* and Sections 79 and 80 of the *CGA*).

(b) ensure that domestically-produced grain is not "misrepresented"; and

27. Canada maintains the quality of Canadian grain in the system through the Canadian quality assurance system, which starts with variety registration before the grain is produced and enters the bulk handling system, and continues with various quality control mechanisms in the system such as inspections and grading standards and procedures. These quality control mechanisms applied to Canadian grain ensure that end-users get a consistent quality of grain from year-to-year and shipment-to-shipment. Because of this quality assurance system, the grades assigned to the grain serve to identify the quality, origin and end-use characteristics of the grain. It is also for this reason that Eastern grain and Western grain are handled separately in the system.

(c) maintain the quality of Canadian grain in the bulk handling system whenever domestically produced grain enters the bulk handling system?

28. Primary elevator operators grade Canadian grain on entry and when the grain moves to transfer and terminal elevators it is officially inspected by the CGC and assigned an official grade. The mixing restrictions that apply to Canadian grain under Section 72 of the *CGA*, are just one of many provisions that also serve to maintain quality, (also see Sections 56, 59, 61 and 70 of the *CGA*).

15. Is there a mechanism equivalent to the section 57 authorisation mechanism that is applied to domestically-produced grain entering the bulk grain handling system? If not, why is such a mechanism necessary?

29. No authorization is necessary for entry of Canadian grain in elevators. The CGC monitors movement of Canadian grain in elevators based on the elevators' reports and on inspections.

30. An authorization request is necessary for entry of foreign grain into elevators and not for entry of Canadian grain into elevators because Canadian grain is subject to the Canadian quality assurance system, while foreign grain is not.

31. The Canadian quality assurance system starts even before the grain enters the bulk grain handling system, with plant breeding and variety registration. For example, in order to be registered, a wheat variety must be visually similar and have the same end-use characteristics as other wheat varieties in its class – this means it will be visually distinguishable from wheat in other classes that have different end-use characteristics. Wheat grown in other countries is not subject to this requirement. Therefore a foreign variety of wheat may look like CWRS (Canada Western Red Spring) wheat but have very different end-use characteristics. There is, therefore, a risk that foreign grain may be misrepresented when entering the bulk grain handling system and affect the quality of Canadian grain exports.

32. Foreign grain may be suffering from certain plant diseases such as *tilletia indica* (Karnal bunt) and *tilletia contraversa kuhn* (TCK or dwarf bunt), or contain certain weed seeds that are not present in Canadian grain, or certain genetically modified grains not authorized in Canada. The CGC monitors shipments deemed to be at risk of contamination and may impose certain conditions such as cleaning of elevators after they have received such foreign grain, in order to ensure that other grain in the system is not contaminated and that it does not affect the quality of Canadian grain exports.

33. Because foreign grain is not subject to the same restrictions and conditions as Canadian grain with respect to production, the Section 57 authorisation mechanism is necessary.

16. With respect to section 72(2) of the Canada Grain Act:

(a) What is the process by which orders issued under section 72(2) are made by the Commission? How is the process initiated? How long does the process generally take? Does the process involve any documentary requirements, costs, etc.?

34. The process is the same as the process for an entry authorization under Section 57 (see description in response to question 13(a)).

(b) Could the Canadian Grain Commission authorise, by regulation, the mixing, in transfer elevators, of all or some Canadian grain with foreign grain of the same type, and/or all or some foreign grain with foreign grain of the same type?

35. The CGC may authorize mixing either by regulation or by order. There is no authorisation requirement for the mixing of different grades and classes of foreign grain. Authorizations to mix foreign grain with Canadian grain in transfer elevators are given by order of the CGC upon request.

- (c) **If so, could such a regulation make the mixing of relevant grain subject to certain conditions, such as appropriate grading designed to ensure consistent quality?**

36. Currently, foreign or mixed grain does not have to meet Canadian grading standards. Foreign grain can be, and almost always is, sold under the grading standard of its own country of origin. If requested, the CGC provides letters of assurance to attest to the quality of foreign grain or of mixed grain. This requires testing of the grain. Such a letter could also include a reference to a comparable Canadian variety and/or grade, where possible.

37. Any advance mixing authorization given by regulation would have to be conditioned upon the identification of the mixed lot as non-Canadian or of mixed origin. In addition, if the CGC were asked to ensure the consistent quality of the grain, additional extensive testing would be required because the CGC has no control over the varieties registered and produced in other countries and would not otherwise be in a position to ensure consistent quality. This would result in additional costs.

17. With reference to paras. 295-300 of Canada's first written submission, is it possible that circumstances might arise where a revenue cap determined by the Canadian Transportation Agency for a particular crop year would constrain the prescribed railways' rate-setting in the course of that year?

38. The railways have been significantly below their revenue caps for the two crop years to date. In total, both railways were \$5,740,944 and \$22,185,969 below their combined revenue caps in crop years 2000/01 and 2001/02.

39. The United States' own findings in the CVD investigation (Exhibit CDA-45) were that the revenue cap provided no benefit. In other words, any constraint on railway revenues is driven by the market, not by the revenue cap.

40. It is expected that the gap between the railways' grain revenues and their revenue entitlement will increase over time because the revenue cap provision includes an upward adjustment for inflation but not a downward adjustment for productivity. This has been the experience to date.

41. Absent unforeseen developments, and in light of the experience of the first two years of the revenue cap regime, we project that the revenue cap will not constrain the prescribed railways' rate-setting in the future.

18. With reference to para. 46 of the US first written submission, is it correct that the railway cars to be allocated by the Canadian Grain Commission under the authority of section 87 of the Canada Grain Act are "government railcars"?

42. No. Any car in the railways' common fleet of cars can be allocated as a producer car. The railway's common fleet of cars comprises cars owned or leased by the railways, cars owned or leased by the Government of Canada and cars owned by the Government of Saskatchewan, by the Government of Alberta and by the CWB. Whether any particular railcar will be assigned to an allocation for a "producer car" is a decision of the railways. Thus, producer cars may or may not be "government railcars".

19. With reference to paras. 312-313 of Canada's first written submission, is Canada arguing that the term "producer" should be construed to mean "Canadian or foreign producer of grain"? If so, does this mean that a US producer, based in the United States, could apply to the Canadian Grain Commission for a railway car without any Canadian intermediary?

43. Yes. Section 87 of the *CGA* is not limited to Canadian producers. Both Canadian producers and US producers can have access to producer cars. Neither the statute nor the regulations provide otherwise. Both would be required to bring their grain to a producer car-loading site on the Canadian railway system. No Canadian intermediary is necessary for a US producer to obtain a producer car.

Both parties:

20. Once a panel has determined that, in making certain export sale(s), an STE did not act in conformity with the standards set forth in Article XVII:1(b), can the panel find a violation of Article XVII:1 on that basis alone, or is it necessary for the panel to make a separate and additional determination whether, in making the export sale(s) in question, the relevant STE did not act in a manner consistent with the general principles of non-discriminatory treatment?

44. No. A finding that an STE did not act in conformity with the standards set out in Article XVII:1(b) alone is not enough to find a violation of Article XVII:1. This is because the first step in determining the existence of a violation under Article XVII:1 is a finding that the STE did not act in a manner consistent with the general principles of non-discriminatory treatment.

45. Article XVII:1(a) sets out the substantive obligation under Article XVII:1: state trading enterprises must act in a manner consistent with the general principles of non-discriminatory treatment. The non-discriminatory treatment is then interpreted and amplified by Article XVII:1(b). Article XVII:1(b) recognises that where it does so in accordance with commercial considerations, an STE may discriminate in its purchases and sales. Support for the proposition that Article XVII:1(b) does not contain an independent obligation may be found not only in the opening sentence of Article XVII:1(b), which unambiguously ties that paragraph to the preceding one, but also in the very structure of Article XVII:1. The “undertaking” in Article XVII:1 is set out in paragraph (a) and is not repeated in paragraph (b); without paragraph (a), paragraph (b) would not impose an obligation on Members.

46. Therefore, the more appropriate view is that there can be no violation of Article XVII:1 where the complainant does not demonstrate, and the panel does not find, conduct that is not in accordance with the general principles of non-discriminatory treatment of GATT 1994.

21. The second clause of Article XVII:1(b) requires STEs to afford enterprises of other Members adequate opportunity "to compete for participation in such purchases or sales".

- (a) **Is the expression "such purchases or sales" a reference to a given STE's "purchases or sales involving either imports or exports", i.e., the expression used in Article XVII:1(a)? In other words, is "such purchases" a reference to a given STE's purchases abroad (imports) and "such sales" a reference to a given STE's sales abroad (exports)?**

47. Yes. The reference to “such purchases or sales” in Article XVII:1(b) is to “purchases or sales involving either imports or exports” identified in Article XVII:1(a). Accordingly, “such purchases” refers to an STE’s purchases abroad (imports) and “such sales” refers to an STE’s sales abroad (exports).

- (b) **Taking the case of an export STE like the CWB, are the relevant "enterprises" of other Members (i) the enterprises which are interested in buying wheat from the CWB (i.e., wheat buyers); (ii) those enterprises competing with the CWB for sales to the same wheat buyers (i.e., wheat sellers) or (iii) other enterprises?**

48. For an export STE, the relevant “enterprises” referred to in the second clause of Article XVII:1(b) are enterprises that are interested in buying wheat from the CWB (that is, wheat buyers). This is clear from the use of the word “participation”. In every purchase and sale there are two sides who participate in the transaction: the seller and the purchaser. The CWB’s competitors do not “participate” in its sales. However, wheat buyers participate in a sales transaction with wheat sellers. Therefore, if the CWB were selling wheat to enterprises in a Member, it must afford “adequate opportunity, in accordance with customary business practice, to compete for participation in such... sales” to wheat purchasers in other Members.

22. Assume a Member has an export STE which has the exclusive right to sell a particular agricultural product for export and domestic consumption. Please indicate whether in the following situations the STE would be making its export sales in accordance with "commercial considerations" within the meaning of Article XVII:1(b):

- (a) The STE charges a lower price in export market 2 than in export market 1 because market 2 is contested by a supplier who benefits from an export subsidy, while market 1 is not.**

49. Yes. In this situation, the STE would be making its export sales in accordance with “commercial considerations” within the meaning of Article XVII:1(b). Commercial actors, generally, do not give up on a market simply because their competitors are subsidised. If this were the case, the mere grant of an export subsidy in respect of a market would result in an effective monopoly on the part of the recipient of the subsidy.

50. Of course, in contesting the market with a supplier who benefits from an export subsidy, an STE would charge the lower price only if it made commercial sense to do so.

51. In the hypothetical posed, the STE would be reacting to market conditions in a manner envisaged in paragraph 1 of *Ad Article XVII*. The supplier who has benefited from the export subsidy has altered the “conditions of supply and demand” in that market. And, as with any other private enterprise, the STE, in charging a lower price in export market 2, would be responding to those changed market conditions.

52. Accordingly, where a competitor sells at a lower price in one market as opposed to another market, for whatever reason, including because it benefits from an export subsidy, for the STE to compete effectively it too must sell at a similar price in that market. The price at which competitors sell in a market is a commercial consideration in determining the price at which the STE will sell on that market.

- (b) The STE charges a lower price in export market 2 than in export market 1 because market 2 is a priority market for the STE (e.g., due to expected growth in import demand) and the lower price is intended to deter other exporters from contesting export market 2. The price charged by the STE in export market 2 would not or could not have been charged in the absence of the special or exclusive privileges enjoyed by the STE.**

53. Yes, in certain circumstances.

54. Charging a lower price in export market 2 than in export market 1 because (a) market 2 is a priority market (for example, because of expected growth in import demand), and (b) the lower price is intended to deter other exporters from contesting export market 2, may be “commercial” behaviour depending on the nature of the market and the other enterprises competing in the market.

55. To the extent that a market is a priority market, it can be expected that a seller would adjust its short-term prices to make long-term gains. This may be done, for example, to build customer loyalty or to familiarize potential customers with the seller's products. Determining the means by which to develop long-term customer relationships is inherently a commercial consideration and is standard commercial practice for any supplier. If the special or exclusive privileges granted to an STE, allow the STE to charge a lower price, doing so is consistent with commercial considerations as it is exactly what any other commercial actor in similar circumstances would do. In fact, for any enterprise to ignore its competitive advantage, however acquired, would be a non-commercial action.

56. In theory, any enterprise, whether an STE or a private trader, with some market power may seek to maximize long-term returns by charging a lower price in a market in order to deter competitors, if the enterprise believed that its competitors would, in fact, be deterred from competing in that market. This would be done with the expectation that the enterprise will subsequently recover in profits the cost associated with this strategy by charging prices above competitive levels. In markets with low barriers to entry or re-entry, however, lowering prices to deter competitors would not be a rational action. Canada notes, in this regard, that markets for agricultural products generally, and wheat in particular, are characterized by extremely low barriers to entry. As such, it would be futile for participants in such markets to pursue the pricing strategy set out in this hypothetical.

57. There is a distinction between non-commercial behaviour and anti-competitive behaviour. Article XVII, or indeed the WTO Agreement, does not prohibit anti-competitive behaviour. If the market structure permits (for example, if barriers to entry or re-entry into a market are high), then selling at a price that is intended to deter other exporters from contesting a market may be commercial behaviour, even if it is anti-competitive. Article XVII:1 is concerned with ensuring that Members do not do through STEs that which they may not do directly. Accordingly, state enterprises may only discriminate in their purchases and sales on the basis of commercial considerations. There being no competition rules in the WTO Agreement, nothing in that Agreement prevents state enterprises from engaging in activities that, though by some definitions may be anti-competitive, are perfectly consistent with commercial behaviour. It is precisely because commercial considerations may lead enterprises to engage in anti-competitive behaviour that some Members have adopted laws prohibiting such behaviour. GATT 1994 does not, however, require such laws, nor does it place disciplines on such behaviour.

58. Finally, a WTO Member that believes it has been disadvantaged by a commercial pricing strategy of an STE as set out in the hypothetical (which a strategy that may not be challenged under Article XVII) is not necessarily without a remedy in the WTO. For example, the WTO Member could consider challenging the special or exclusive privileges to which the STE's low prices are attributable under other WTO disciplines, such as the *Agreement on Subsidies and Countervailing Measures* or the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994*.

- (c) **The STE charges a higher price in export market 1 than in export market 2 because the price-elasticity of import demand is lower in export market 1 than in export market 2.**

59. Yes. In this situation, the STE would be making its export sales in accordance with "commercial considerations" within the meaning of Article XVII:1(b). If the economic conditions in market 1 allow the STE to sell at a higher price, then doing so is in accordance with commercial considerations. A private trader in similar circumstances as the STE would also charge a higher price in market 1 to take advantage of the lower price-elasticity of import demand.

- (d) **Same as (c), but the STE in addition extracts monopoly rents (price premiums) in both markets, which it could not do but for its exclusive right to export the**

product concerned (assume the STE's product is perceived as superior in quality for instance, such that there is no significant competition from other products).

60. Yes. Extracting monopoly rents (price premiums) in export markets is commercial behaviour. Indeed, such an action is, by definition, undertaken in accordance with “commercial considerations”. In fact, exacting such rents is so tempting on the part of private sector enterprises that some WTO Members have competition laws and authorities to regulate precisely such activities.

61. Of course, a state enterprise – or indeed any enterprise – may “exact” monopoly rents only in markets in which it has a monopoly. In this sense, and especially in respect of export monopolies, there is a fundamental distinction between, on the one hand, the exclusive right to export a product and, on the other, a monopoly in an export market for that product. One does not necessarily flow from the other. For one thing, an exclusive right to export a product is in the power of the Member making such a grant. No Member, however, has the right to grant a monopoly in an export market for its products. For another, the existence of a monopoly in an export market depends entirely on the structure of that other market, including demand elasticity and the ease of market entry by other exporters. For example, while the CWB enjoys the exclusive right to export wheat from Western Canada, it does not enjoy a monopoly, either legal or market-based – in any of the markets in which it competes.

62. An export monopolist may, therefore, exact “monopoly rents” in international markets, by virtue of the export monopoly, only in the rare circumstance where the exporting country is the sole source of the commodity or product for the market in question. Otherwise, the export monopolist will be just another commercial player in the international market.

63. An exporter that enjoys market power will exact rents appropriate to its power so as to maximize returns. It will do so irrespective of whether its market power results from an exclusive right granted by the State or whether its market power (the monopoly) has been gained on the market, be it through superior quality, internal growth or through mergers and acquisitions.

64. In circumstances where an STE enjoys both an exclusive right to export and a monopoly in an export market, to consider monopoly rent seeking by that STE as not being in accordance with “commercial considerations” would be an attack against the grant of the exclusive right to export. That Members of the WTO are entitled to grant such an exclusive right is expressly authorized by Article XVII. An interpretation that would negate this right would obviously be erroneous.

65. Canada notes that some WTO Members have competition laws, pursuant to which the extraction of monopoly rents by dominant suppliers may be prohibited under certain circumstances. For the time being, however, the WTO, and more specifically Article XVII, contains no competition rules.

23. Is the "commercial considerations" requirement in Article XVII:1(b) essentially intended to make sure that STEs use their special or exclusive privileges in such a way that their purchases or sales involving imports or exports are made on terms which are no more advantageous for the STE than they would have been if the STE did not have any special or exclusive privileges? Or is the "commercial considerations" requirement essentially intended to make sure that STEs act like rational economic operators, i.e., that, in their purchase or sale decisions, they are guided only by the consideration of their own economic interest?

66. The “commercial considerations” requirement is intended to make sure that STEs act like rational economic operators. If an STE discriminates in its purchases or sales decisions (for example, sells to one purchaser but not another because of the country of origin of the purchaser) the

discrimination must be based on commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase and sale.

67. This interpretation is supported by two considerations.

68. First, if the first proposition were to prevail, it would automatically turn any subsidy granted to an STE that can be characterized as a “special and exclusive privilege” and that provided the STE with a commercial advantage into a prohibited subsidy. However, Article XVII is manifestly not a subsidy-regulation provision under GATT 1994; and nothing in GATT 1994 or elsewhere in the WTO Agreement suggests that Article XVII provides for a new category of prohibited subsidies.

69. Second, the commercial considerations requirement cannot properly be interpreted to mean that an STE must use its special or exclusive privilege in such a way that the purchases or sales involving imports or exports are made on terms that are no more advantageous for the STE than they would have been if the STE did not have any special or exclusive privileges because that would nullify Member’s rights under Article XVII. If the first interpretation were to prevail, a Member could grant exclusive or special privileges to an STE, but if the STE utilized those exclusive or special privileges, the Member would be in violation of its obligation under Article XVII.

24. Pursuant to Article XVII:1(a), each Member undertakes that its STEs "shall" act in a specified manner. Please explain the meaning and usage of the term "shall" in Article XVII:1(a). In particular, what, if any, difference in meaning would there be if Article XVII:1(a) had said that each Member "undertakes" that its STEs "will" act in the specified manner?

70. The word “undertakes” creates a positive obligation on the part of Members in respect of the conduct of state trading enterprises. In this context, there is no difference between “shall” and “will”, because either way, the Member is answerable in respect of the discriminatory conduct of the STE in question.

Canada:

36. With reference to paras. 46 and 150 of Canada's first written submission, are all Western Canadian wheat farmers automatically members of the CWB?

71. There is no membership in the CWB. Western Canadian producers who, (a) choose to produce wheat and barley, and (b) wish to sell the wheat and barley they produce for export or for domestic human consumption must apply for a CWB permit book and market such grain through the CWB. These same producers also vote for the Board of Directors of the CWB.

37. Is the CWB required to purchase all Western Canadian wheat that is offered to it? If not, has the CWB made use of the possibility to refuse to purchase Western Canadian wheat, for instance in a situation where there was an oversupply of wheat in international markets?

72. The CWB is not required to purchase all Western Canadian wheat that is offered to it. There have been numerous instances in the past where the CWB has not accepted all of the wheat offered to it for delivery, particularly with respect to durum wheat.³

38. Is the CWB required to sell all wheat purchased by it, or could the CWB decide not to market all wheat purchased, for instance if doing so would maximise returns to farmers? If the

³ For example, see Exhibit CDA-54 for Contract Acceptance Levels for 1995-96 to 2001-02.

CWB is required to sell all wheat purchased, is the CWB required to market wheat within a particular time-period after purchase, or is it free to determine when to sell?

73. The CWB is not required to sell all of the wheat that it purchases, and it could decide not to market all wheat purchased if doing so would maximize returns to farmers.

74. Any such decision would be driven by considerations such as the cost of storing the grain in the commercial handling system and the logistical implications of retaining those stocks. For example, the CWB does not own grain storage facilities. And so, the benefit of retaining the stocks would have to be weighed against the additional storage fees that the private grain handlers would charge the CWB. Similarly, the capacity of the Canadian grain handling and transportation system is relatively constrained such that it requires regular turnover to remain efficient and effective. Thus, withholding stocks of certain products would lessen the system's capacity to handle other products. That in turn could result in foregone revenue from those other products. So again, the costs and benefits of the decision would have to be weighed.

39. With reference to para. 31 of the US first written submission, is the income generated by CWB short-term investments financed through government-guaranteed borrowing "pool money" that is "returned" to farmers? If not, is this income at the disposal of the CWB such that it could be used, for instance, to finance export sales, which do not cover the price, paid to farmers less marketing expenses?

75. Income generated from investments is paid into the pool accounts. Income paid to pool accounts is done in accordance with Section 8 of the *CWB Act*, which specifies that these earnings are to be used to pay "expenses incurred by the Corporation in its operations". Surpluses remaining in the pool accounts must be paid out to producers.

40. Regarding the 1998 amendment to the *CWB Act* (US first written submission, para. 66), why was it deemed necessary to insert a "NAFTA-clause", but not a "WTO-clause"?

76. The decision in 1998 was not one of including a "NAFTA-clause" and/or a "WTO-clause". A NAFTA-clause already applied to the CWB as a Crown corporation under the *Financial Administration Act* (the "FAA") and the decision was to continue this requirement for the CWB once it was no longer a Crown corporation.

77. Section 61.1 of the *CWB Act* (the "NAFTA-clause") is an identical provision to that of Section 154.1(1) of the *FAA*.⁴ Section 154.1(1) of the *FAA* applies to all Crown corporations. On 31 December 1998, when the first elected CWB directors assumed office, the CWB ceased to be a Crown corporation. Therefore, in order for this provision to continue to apply to the CWB, it was incorporated into the *CWB Act*. The wording of the two provisions is identical except for changes that were necessary to alter a general provision (i.e., applying to all Crown corporations) to a particular one (i.e., applying to a particular corporation, the CWB).

78. A "NAFTA-clause" was inserted in the *FAA* and, subsequently, in the *CWB Act*, because of the nature of the obligation in NAFTA. The relevant provisions are Article 1502(2) and 1503(2), which both begin with the phrase "[e]ach Party shall ensure, through regulatory control, administrative supervision or the application of other measures...". The wording of Articles 1502(2) and 1503(2) of the NAFTA is significantly different from that of Article XVII of GATT 1994. Accordingly, Canada's implementation of those obligations through a "NAFTA clause" is of limited relevance in determining the scope and nature of the obligation set out in Article XVII. The repeated reference by the United States to the "NAFTA clause" in the *CWB Act* as proof that Canada is in

⁴ Exhibit CDA -55.

violation of its WTO obligations is nothing less than an impermissible attempt to import the language of NAFTA into the WTO Agreement, an attempt that the Panel should resist.

79. In any event, to the extent that a “WTO clause” might be relevant to the performance of Canada’s obligations under Article XVII, the Panel might wish to consider that Article 103(1) of the NAFTA affirms the rights and obligations of the Parties to each other under GATT 1994. This includes Article XVII. A requirement to respect the NAFTA, in the context of a “NAFTA clause”, also necessarily incorporates a requirement to respect the requirements of GATT 1994, including those of Article XVII.

80. Therefore, not only is “WTO clause” not required by Article XVII, but it would be redundant in the face of a “NAFTA clause”.

41. If a particular provision of the *CWB Act* were open to more than one interpreting and one of these interpretations would result in an inconsistency with Article XVII, would a Canadian judge need to construe the *CWB Act* so as to conform to Canada's obligations under Article XVII?

81. Canada is a dualist parliamentary common law jurisdiction. Canada “receives” customary international law through judicial interpretation and application of the common law. However, treaty obligations require implementing legislation to be in force domestically and are not incorporated into domestic law upon ratification.

82. In the past, having due regard to Canada’s parliamentary tradition, Canadian courts applied the law laid down by statute even if inconsistent with a treaty binding on Canada. In such rare circumstances, Canada would have been liable internationally for any consequent breach of its treaty obligations.

83. The situation has, however, evolved. In recognition of Canada’s extensive web of international obligations, courts have been prepared to interpret domestic law so as to conform as far as possible with international law. Recent examples of this include *Baker v. Canada (Minister of Citizenship and Immigration)*⁵ and *114957 Canada Ltee. (Spraytech, Societe d'arrosage) v. Hudson (Town)*.⁶ In both cases, the Supreme Court of Canada endorsed the following statement⁷ from a prominent commentator on statutory construction:

[T]he legislature is presumed to respect the values and principles enshrined in international law, both customary and conventional. These constitute a part of the legal context in which legislation is enacted and read. In so far as possible, therefore, interpretations that reflect these values and principles are preferred.⁸

84. Accordingly, where treaty obligations are not directly incorporated into Canadian law, Canadian courts consider international treaty obligations as “relevant context” in interpreting constitutional and statutory provisions.

⁵ [1999] 2 S.C.R. 817 (Exhibit CDA-56).

⁶ [2001] 2 S.C.R. 241 (Exhibit CDA-57).

⁷ Found at pp. 861 and 266 respectively [emphasis added by courts].

⁸ Ruth Sullivan, *Driedger on the Construction of Statutes*, 3rd ed. (Toronto: Butterworths, 1994), p. 330 (Exhibit CDA-58).

Both Parties:

42. As a supplement to Exhibit CDA-24, could the parties provide an estimate of the volume and proportion of US-origin grain imported into Canada for domestic consumption as compared to that imported for re-export?

| VOLUME OF US-ORIGIN GRAIN IMPORTS (TONNES)⁹ | | | |
|---|--|-----------------------------------|--------------|
| Year Ended | Domestic Consumption (Proportion) | Re-export (Proportion) | Total |
| 31 July 2003 | 5,385,196 (79%) | 1,474,092 (21%) | 6,859,288 |
| 31 July 2002 | 5,138,744 (71%) | 2,064,337 (29%) | 7,203,081 |
| 31 July 2001 | 3,562,392 (66%) | 1,854,785 (34%) | 5,417,177 |

43. Are the findings at para. 11.169 of the panel report on *Argentina - Hides and Leather*¹⁰ mutatis mutandis and at paras. 8.133-8.134 of the panel report on *US - FSC (Article 21.5 - EC)*¹¹ relevant to this Panel's assessment of whether the grain segregation and rail transportation measures give rise to differential treatment as between "like" products within the meaning of Article III:4 of GATT 1994?

85. The findings of the panel in *Argentina - Hides and Leather* and of the panel in *US - FSC (Article 21.5 - EC)* are not applicable. Canada does not argue that no US-origin grain is like Canadian-origin grain simply because of its origin. However, because Canadian and US-origin grain are not subject to the same quality assurance system, different treatment of the Canadian and US-origin grain does not amount to "treatment less favourable" under Article III:4.

44. Are all imported and domestic products falling within each of the categories of "grains" as defined in section 5(1) of the *Canada Grain Regulations* "like products" for the purposes of Article III:4 of GATT 1994, or are there different "like" products within each of the categories of grain? Are all imported and domestic products falling within each of the categories of "grains" or "crops" as defined in section 147 of the *Canada Transportation Act* "like products" for the purposes of Article III:4 of GATT 1994, or are there different "like" products within each of the grain or crop categories?

86. For the purposes of the *CGA*, not all grain types are like. For example canola is not like wheat as they have different characteristics and end-uses. In addition, within each type of grain there are different "like" products. For example, the top quality of barley is used for malting whereas the lower quality is used for feed purposes only. The sale prices as well as end-uses of these two products are different. Elevators would therefore ensure that these two qualities of barley are kept separate from one another. There are many different classes of wheat produced in Canada that have different inherent characteristics and are grown for different uses, such as hard red spring wheat (for bread) as

⁹ Statistics Canada and Canadian Grain Commission data.

¹⁰ Panel Report, *Argentina – Measures Affecting the Export of Bovine Hides and Import of Finished Leather* ("Argentina – Hides and Leather"), WT/DS155/R and Corr.1, adopted 16 February 2001.

¹¹ Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities ("US – FSC (Article 21.5 – EC) ")*, WT/DS108/RW, adopted 29 January 2002, as modified by the Appellate Body Report, WT/DS108/AB/RW.

opposed to soft white winter wheat (for cookies). Some varieties of sunflower seed are grown for oil and others for food use.

87. For the purposes of the *CTA*, each type of grain is a different "like product".

45. Could the parties respond to the EC's assertion in paragraph 43 of its third party written submission that a bulk grain handling system, such as that covered by the Canada Grain Act, "offers cost advantages compared to other ad hoc distribution possibilities."

88. We understand the EC to suggest that it is more cost efficient for a farmer to go through the Canadian bulk grain handling system than to sell its grain directly to end-users. It is not clear on what basis the EC makes such an assertion, as it provides no evidence in support.

89. The EC allegation is not correct and reflects a misunderstanding of the economic realities of the North American grain market.

90. Bulk grain handling facilities such as primary elevators are efficient at accumulating grain from many local grain producers (who deliver relatively small lots by truck) and loading it on railway cars, which are then transported over long distances in multi-car blocks. Both Canada and the United States have bulk handling systems. In the vast majority of cases, a US farmer is closer to a US primary elevator than to a Canadian primary elevator. It is therefore more efficient (and cost-effective) for US-origin grain to be accumulated in US elevators and for US rail cars to deliver the grain directly to rail car unloading facilities operated by end-users, than it is for a US farmer to truck grain to a Canadian elevator. As well, using primary elevators is not cost free. Canadian primary elevators charge a minimum of \$10-\$15/tonne (roughly twice as much as US elevators). Storage, drying and other services, if required, would result in additional costs. Therefore, given that in the majority of cases US-origin grain has already been delivered through a primary elevator in the United States, there would be no reason to incur a second handling charge by delivering grain to a Canadian primary elevator.

91. A US shipper would not normally want to incur extra charges if grain could be shipped directly to an end-user. In fact, most grain destined for the Canadian market, whether of US or Canadian origin, goes directly to end-users.

Canada:

57. Does Canada have a way of knowing whether imported grain, once it enters the bulk grain handling system, is destined for domestic consumption/use, or for re-export?

92. In the case of a primary elevator, the destination of the grain is provided to the CGC with the request for authorisation to receive foreign grain.

93. When imported grain is received into a terminal or transfer elevator it is registered on the CGC's electronic registration system. At this point the destination of the grain is unknown. Once the grain leaves the elevator, the elevator is required to register the destination of the grain on the CGC's electronic registration system. The CGC would then know if the grain is destined to a domestic end-user or is being re-exported. The same process applies to domestic grain.

58. With respect to section 56(1) of the Canada Grain Regulations, how is Eastern Canadian grain which has been mixed graded? For instance, is it graded as "Eastern Canadian Soybeans - Mixed" in a case where soybeans of different grades are mixed?

94. In the case of some types of grain, such as wheat or corn, there are grades established for grain produced in Western Canada (western grain) and grain produced in Eastern Canada (eastern grain), because these types of grain are produced in both regions, but are of different varieties and quality or end-use characteristics. The “Eastern” or “Western” designation identifies the regional origin of the grain. In the case of some other kinds of grain, like soybeans, which are only produced in significant volumes in eastern Canada, the established grades do not specify eastern or western, but simply identify the grain as Canada origin. Due to the differences in quality between eastern grain and western grain, they are not mixed together in the handling system, unless specifically authorized by CGC.

95. If different grades of a class of eastern grain, for example White Winter Wheat, have been mixed together, the combined lot would be graded according to the specifications the lot meets. For example, if #1 Canada Eastern White Winter Wheat is mixed with #3 Canada Eastern White Winter Wheat, the combined lot may meet the specifications for #2 Canada Eastern White Winter Wheat and would be graded as such.

59. With respect to the section 72(2) orders by the Canadian Grain Commission that are contained in Exhibits CDA-28, 29 and 30:

(a) Have there been orders pursuant to which the mixing in transfer elevators of Canadian and foreign grain or of foreign grain only was rejected?

96. No request for mixing of Canadian and foreign grain in transfer elevators has been denied.

97. No authorization is necessary for mixing of foreign grain with foreign grain.

(b) have there been instances where domestic grain was granted mixing authorisation under section 72(2) in situations not covered by the authorisations contained in section 56 of the Canada Grain Regulations?

98. Yes, requests to mix the top two grades of milling wheat at terminal elevators are frequently made by the CWB, and granted by the CGC.

60. Do any procedures apply for the mixing of Eastern Canadian grain pursuant to section 56 of the Canada Grain Regulations? If so, what are they?

99. Subsequent to mixing, Eastern Canadian grain has to be inspected to determine the grade of the mixed lot, subject to Section 50 of the *Regulations*.

61. In para. 228 of its first written submission, Canada states that there is a process whereby the Canadian Grain Commission allows receipt of US-origin grain into transfer elevators on an annual basis. Could Canada provide further information and evidence regarding such orders? Is this process available to foreign grain other than US-origin grain?

100. At present, annual consent has been given for US-origin grain only. Annual consent was given for all foreign grain until 2002, when Canada encountered some phyto-sanitary problems with imports of Ukrainian-origin grain. Consent could be given for an elevator to handle several shipments of foreign grain or a series of shipments over the course of a period of time, on request, and that request would be granted if the CGC did not have any phyto-sanitary concerns and was given information regarding its destination. Two examples of such requests and authorizations are attached as Exhibit CDA-59 [both contain strictly confidential information].

101. Advance consent orders are automatically issued to transfer elevators year after year, although they are often adjusted on request.

62. With respect to the Wheat Access Facilitation Programme referred to at paras. 196 and 229 of Canada's first written submission, please answer the following questions:

(a) Has the programme ever been used by US grain producers? (see Canada's first written submission, para. 239)

102. US-origin grain producers have never availed themselves of this Programme. Although about thirty Canadian elevators registered in the programme to receive US-origin wheat, US producers did not deliver any wheat to these elevators. Economic realities are the most likely explanation: for any number of reasons, including the weakness of the Canadian dollar, wheat prices at elevators were simply too low in Canada, or alternatively, handling charges too high compared to US handling charges. It has been more attractive for US farmers to deliver their wheat to US elevators.

103. Indeed, as part of a 6-month review of the *Canada-US Record of Understanding*, Agriculture and Agri-Food Canada contacted Canadian primary elevators to seek their views on the WAFP. Canadian elevator operators noted that:

- US producers had not used the programme because of the price spread between Minneapolis and Canadian values;
- they could not find customers wanting US wheat, or willing to pay the company's margins to get it; and
- prices in Canada were not good enough to persuade a US farmer to participate.

(b) Is this programme applicable to grain other than wheat?

104. No. The programme was implemented at the request of the US government in respect of wheat.

(c) Is this programme applicable only to Western Canadian primary elevators? (Exhibit CDA-27, p.7)

105. Yes. The programme was designed at the request of the US government to facilitate access of US-origin grain into Western Canadian primary elevators.

(d) Is this programme applicable to foreign grain other than US-origin grain?

106. No. This programme was specifically designed to respond to a US government request.

(e) How does the "advance consent" system work in practice? How do elevator operators wishing to import US wheat proceed?

107. An explanation of how the programme works is contained in the CGC Memorandum to the Trade (Exhibit CDA-60).

63. With reference to para. 263 of Canada's first written submission, could Canada elaborate on why the grain segregation measures are "necessary" in order to "secure compliance" with the grading provisions of the Canada Grain Act, the Canada Wheat Board

Act and what Canada refers to as the misrepresentations and consumer protection provisions of Canada's competition laws?

108. Because foreign grain is not subject to the same quality assurance system as Canadian grain, if US wheat, for example, were mixed with Canadian wheat, the CGC would no longer be able to visually grade Canadian wheat. Unlike Canadian-origin wheat, US-origin wheat is not subject to the same requirement for visual distinguishability between varieties with different end-use characteristics. Thus, the Canadian visual grading system cannot function properly and maintain segregation in the system according to particular qualities desired by end-users if US-origin wheat is commingled with Canadian-origin wheat.

109. In addition, most US wheat is grown from varieties not registered in Canada. If mixing occurred with no restrictions, the specific end-use characteristics could no longer be ensured. In Canada, if a variety does not perform well (that is, meet the acceptable criteria and end-use characteristics for its class) it will not be registered. For example, at the end of two years of testing in Canada, the Alsen wheat variety was refused registration because of poor quality performance. This variety is grown extensively in the United States. Segregation requirements for foreign grain that is not subject to the Canadian quality assurance system is necessary to maintain the integrity of the Canadian grading system.

110. In addition, the measures are necessary to secure compliance with Canada's unfair competition and consumer protection because, in order to determine the origin of the grain in the grain handling system, it is necessary to keep grain of different origins separate from one another and to identify them properly if they are mixed so as not to misrepresent them. This is particularly important where the grain is exported as the importing country often requires a certification that the grain is Canadian origin grain. If Canada were not able to determine the origin of the grain in its grain handling system, it would not be able to provide this assurance to countries purchasing its grain and to comply with section 32 of the *CGA*. No other measure is reasonably available that would ensure strict compliance with the prohibition against misrepresentation of origin.

111. Finally, the measures are necessary to secure compliance with the provisions establishing the CWB as a single desk exporting STE, as contained in the *CWB Act*, because the relevant CWB privileges apply to the sale of Canadian wheat for export or for domestic human consumption; if foreign wheat were not distinguished from Canadian wheat, the monopoly authority of the CWB could not be enforced.

64. Could Canada please provide support for its assertion at paras. 286 and 287 of its first written submission that (i) the setting of rates is left entirely to the prescribed railways; and (ii) that for all movements that include a non-revenue cap portion, the railways have the discretion to charge what the market will bear, regardless of what the rate may be for the revenue cap portion of the movement?

112. (i) Railways charge differential rates, that is, what the market will bear, as referenced in reports of the Canada Transportation Act Review Panel and the US Surface Transportation Board.¹² There are no provisions in the revenue cap section of the *Canada Transportation Act* (see Part III of Exhibit US-9) or elsewhere that set rate limits on individual grain movements with the following minor exceptions (which are not at issue in this case):

- (a) single car rates for revenue cap movements from branch lines cannot exceed single car rates for substantially similar revenue cap movements from mainline points by more than 3 per cent;

¹² See para. 289 of Canada's First Written Submission and Exhibits CDA-34 and CDA-45.

- (b) the Canadian Transportation Agency (the “Agency”) sets “interswitching” rates for all traffic that originates within 30 kilometres of a point where traffic can be inter-changed between two railways; and
- (c) the Agency has a limited ability to set rates for all traffic that is inter-changed between two railways outside the 30 kilometre “interswitching” limit in the event the two railways and/or shipper cannot agree on the rate.

113. (ii) Railways charge differential rates, i.e. what the market will bear, as referenced in reports of the Canada Transportation Act Review Panel and the US Surface Transportation Board.¹³ There are no provisions in the *CTA* (see Part III of Exhibit US-9) that set rate limits on individual grain movements that are not covered by the revenue cap provisions, including the portion of movements that originate or terminate outside the geographic territory covered by the revenue cap, with the following minor exceptions (which are not at issue in this case):

- (a) the Agency sets “interswitching” rates for all traffic that originates within 30 kilometres of a point where traffic can be inter-changed between two railways; and
- (b) the Agency has a limited ability to set rates for all traffic that is inter-changed between two railways outside the 30 kilometre “interswitching” limit in the event the two railways and/or shipper cannot agree on the rate.

65. Could Canada please explain why the statement at page 36 of Exhibit CDA-34 that “the cap was to allow flexibility in grain transportation rates while simultaneously giving protection to farmers by constraining the total revenues the railways could capture from moving grain” does not suggest that foreign producers would be treated less favourably with respect to movements covered by the cap?

114. The purpose of the revenue cap when it was established was indeed to give protection to farmers while providing flexibility in setting rates in order to encourage competition and efficiencies. The revenue cap was only one element of government policy reforms that were aimed making the system more commercial, competitive and accountable.

115. The Agency’s analysis, which was accepted by the United States in the CVD case, is evidence that the Canadian government’s policy reforms have achieved this objective and that any constraint on railway revenues is now driven by the market, not by the revenue cap.

116. Because the revenue cap does not constrain railway revenues, it does not result in less favourable treatment for foreign producers.

¹³ Ibid.

ANNEX A-3

RESPONSES OF AUSTRALIA TO QUESTIONS POSED IN THE CONTEXT OF THE FIRST SUBSTANTIVE MEETING OF THE PANEL

(24 September 2003)

Question 1

1. As noted in the submission of Australia to the Panel, Australia considers that subparagraph XVII:1(b) is to be viewed as a component of the obligation defined in subparagraph XVII:1(a). The elements of subparagraph XVII:1(b) are to be applied to assist a Panel in determining whether the standard of behaviour laid down in subparagraph XVII:1(a) has been met. Subparagraph XVII:1(b) is not a separate standard for STE behaviour and does not found a separate obligation on Members.

2. The first task of any Panel therefore is to determine whether the MFN and National Treatment principles are applicable to the act in question within the factual context of the dispute. In then applying these principles to the facts, the Panel is to utilise, as appropriate to the principle being applied, the definitional assistance provided in subparagraph XVII:1(b).

Questions 2 and 3

3. Both questions 2 and 3 appear to consider the meaning and application to various hypothetical situations of the elements of subparagraph XVII:1(b) in isolation from the general principles of non-discriminatory treatment which they further define and elaborate. As noted above, Australia does not consider this to be appropriate. Further, application of Article XVII:1 should be undertaken on a case by case basis, having regard to the actual facts at issue. However Australia does wish to make the following points concerning interpretation and application of Article XVII:1(a) and (b) which would be applicable to such questions.

4. Australia submits that in examining any act complained of under Article XVII it is first necessary to consider which non-discriminatory principle/s are applicable to the particular purchasing or selling situation. They are not both necessarily applicable to every situation. When this is determined, it must be considered which of the elements of subparagraph XVII:1(b) are applicable to the behaviour subject to complaint, including their appropriate relationship to each general principle. They may then be applied, having regard to all the facts of the case, as part of examining whether the STE has acted in a manner consistent with the applicable general principles.

5. A particular purchase or sale by an STE for import or export to which the principle of MFN or the principle of National Treatment is *not* applicable cannot be separately tested for its 'commerciality' or whether adequate opportunity has been provided to other Member's enterprises to compete in that purchase or sale.

6. As an STE's exporting behaviour has not before been considered under Article XVII, and the issue of export behaviour has hardly been considered in terms of the application of MFN or National Treatment under GATT 1994, the appropriate application of either principle has not been examined in regard to a similar factual situation as this dispute.

7. With regard to the application of the MFN principle to sales for export, Australia notes that pursuant to the Interpretive Ad Note to Article XVII, price discrimination between export markets for commercial reasons will not fall foul of this principle. Moreover it does not appear consistent with how MFN has been applied and interpreted under GATT 1994 for an exporting Member's (or its STE's) MFN obligation to be considered to include a concurrent obligation to all other Members to afford them adequate opportunities to compete for participation in the market for which that Member's exports are destined.

8. Australia would also note that the way in which special or exclusive privileges have been considered in the hypotheticals does not properly distinguish the key issue - that it is not what privileges or monopoly rights (which are permissible under GATT 1994) may *enable* an STE to do, but whether what it actually *does* (in terms of purchases or sales involving either imports or exports) is consistent with the general principles of non-discriminatory treatment of GATT 1994.

9. Application of Article XVII to any STE purchase or sale must be undertaken on a case by case basis, having full regard to the particular commercial circumstances of the case. The hypothetical scenarios do not capture the complex interaction between the many factors that influence world market prices for agricultural products, including factors such as the market structure, the impact of government policies, variations in product quality, and other changes in variables influencing demand/supply for a particular product in a particular market.

Questions 4 and 5

10. As with the response to questions 2 and 3, Australia does not consider that the content and meaning of 'the commercial considerations' requirement can be considered in isolation from the applicable general principle of non-discrimination that it is used to further define.

11. Article XVII is not intended to place STEs with such privileges on the same footing as non-privileged enterprises. Each form of enterprise is equally consistent with GATT 1994. Australia considers the purpose of Article XVII:1 was simply to require that all STEs, whether exercising such privileges or not, act in a way that is not inconsistent with the general principles of non-discriminatory treatment governing international trade under GATT 1994 – including by acting consistently with commercial considerations.

12. Australia considers that the particular factual situation of the case at issue is of relevance in considering the action complained of in terms of 'commercial considerations'. This would include consideration of the type of STE undertaking such purchases or sales for import or export as well as the particular commercial context in which that STE operates and the nature of the actions subject to complaint.

Question 6

13. The current text is unambiguous. The word 'shall' signifies the treaty- level obligation that Members are here undertaking concerning the acts of their STEs. It is used for all substantive obligations of Members under GATT 1994. There is little relevance in considering whether the use of the word 'will' would make a difference in meaning to Article XVII.

Question 7

14. As was stated in the Australian submission to the Panel, the undertaking of Members in Article XVII:1(a) concerning the behaviour of their STEs does not impose any direct obligation on a Member beyond an obligation of result. It cannot be interpreted to imply further obligations concerning how an individual Member should meet this undertaking.

Question 8

15. Australia does not see how the National Treatment principle can be considered to prohibit discrimination by an STE in terms of sale between its export market and its domestic market - that is discrimination between internal and external markets. The essence of National Treatment is the prevention of discrimination within the internal marketplace. The nexus to what happens in the external marketplace would not seem relevant to an inquiry into such discrimination.

16. Australia would also note that domestic and export markets are driven by different and particular conditions of supply and demand which will impact on the price that can be realised in each market. Different behaviour, including as regards pricing, by an STE in its domestic and in its export markets does not *per se* equate to or signify some form of 'discrimination'.

ANNEX A-4

RESPONSES OF CHINA TO QUESTIONS POSED IN THE CONTEXT OF THE FIRST SUBSTANTIVE MEETING OF THE PANEL

(24 September 2003)

MEASURES RELATING TO EXPORTS OF WHEAT

1. Once a panel has determined that, in making certain export sale(s), a STE did not act in conformity with the standards set forth in Article XVII:1 (b), can the panel find a violation of Article XVII:1 on that basis alone, or is it necessary for the panel to make a separate and additional determination whether, in making the export sale(s) in question, the relevant STE did not act in a manner consistent with the general principles of non-discriminatory treatment.

Answer

On this point we agree with the Panel on *Korea – Beef* that took the view that “...the terms ‘general principle of non-discrimination treatment prescribed in this Agreement’ (Art. XVII:1(a)) should be equated with ‘make any such purchases or sales solely in accordance with commercial consideration’ (Art. XVII:1(b)). A conclusion that the principle of non-discrimination was violated would suffice to prove a violation of Article XVII; similarly, a conclusion that a decision to purchase or buy was not based on ‘commercial considerations’, would also suffice to show a violation of Article XVII.”¹

We think that the Panel on *Korea – Beef* case gave the proper interpretation of the relation between Article XVII:1(a) and Article XVII:1(b).

2. The second Clause of Article XVII:1(b) requires STEs to afford enterprises of other Members adequate opportunity to “to compete for participation in such purchases or sales”

- (a) **Is the expression “such purchases or sales” a reference to a given STE’s “purchases or sales involving either imports or exports”, i.e., the expression used in Article XVII:1(a)? In other words, is “such purchases” a reference to a given STE’s purchases abroad (imports) and “such sales” a reference to a given STE’s sales abroad (exports)?**

Answer

Under Article XVII: 1 (a), WTO Members undertake that if they establish or maintain a state enterprise, or grant exclusive or special privileges to any enterprise, such enterprise shall , in its purchases or sales involving either imports or exports, act in a manner consistent with the general

¹ Panel report on *Korea – Various Measures on Beef*, para. 757.

principles of non-discriminatory treatment, which is further required by explanation in Article XVII:1(b) to mean that such enterprises shall make any such purchases and sales solely on the basis of commercial considerations and shall afford the enterprises of the other Members adequate opportunity, in accordance with customary business practices, to compete for participation in such purchases or sales.

Therefore, the expression “such purchases or sales ” is a reference to a given STE’s “purchases or sales involving either imports or exports”, i.e., the expression used in Article XVII:1(a).

- (b) Taking the case of an export STE like the CWB, are the relevant “enterprises” of other Members (i) the enterprises, which are interested in buying wheat from the CWB (i.e., wheat buyers); (ii) those enterprises competing with the CWB for sales to the same wheat buyers (i.e., wheat sellers) or (iii) other enterprises?**

Answer

Our position is that the relevant “enterprises” are (i) buyers of Canadian wheat, and (iii) other enterprises— e.g., wheat suppliers to CWB. Article XVII:1(b) states that “such enterprises shall ... afford the enterprises of the other contracting parties adequate opportunity ... in such purchases or sales.” In the case of CWB, “purchases” mean the purchases of CWB from its suppliers and “sales” mean the exports made by CWB. To comply with Article XVII:1(b), CWB must give adequate competing opportunity to buyers in its sales(i.e. exports), and suppliers in its purchases. With respect to (ii) competitors, CWB has no such obligation, because it is not in a superior position than its competitors for sales to the same wheat buyers. They are on the same line competing with each other.

3. Assume a Member has an export STE which has the exclusive right to sell a particular agricultural product for export and domestic consumption. Please indicate whether in the following situations the STE would be making its export sales in accordance with “commercial considerations” within the meaning of Article XVII:1(b).

- (a) The STE charges a lower price in export market 2 than in export market 1 because market 2 is contested by a supplier who benefits from an export subsidy, while market 1 is not.**

Answer

Yes, this is in compliance with commercial consideration requirement within the context of Article XVII:1(b). The *Ad* Article XVII paragraph 1 states:

“The charging by a state enterprise of different prices for its sales of a product in different markets is not precluded by the provisions of this Article, provided that such different prices are charged for commercial reasons, to meet conditions of supply and demand in export markets.”

If a subsidized supplier charges a low price, it will be certain that the original equilibrium of demand and supply in this market will be broken and will be forced to shift to a new market situation favourable to the subsidized suppliers, which means that the situation of demand and supply will change. To meet this new situation of demand and supply, i.e., the new market competition situation, a STE has to quote and charge a competing price. This situation falls just within the scope of the above *Ad* note.

- (b) The STE charges a lower price in export market 2 than in export market 1 because market 2 is a priority market for the STE (e.g., due to expected growth**

in import demand) and the lower price is intended to deter other exporters from contesting export market 2. The price charged by the STE in export market 2 would not or would not have been charged in the absence of the special or exclusive privileges enjoyed by the STE.

Answer

To charge a competing price, which might be lower than that charged in market 1, to deter other exporters from contesting export market 2 for maintaining a priority market or its prior market share is a normal practice based on the commercial considerations according to the market competition situation even if the price would not be charged in the absence of the special or exclusive privileges. If maintaining a priority market by deterring competitors is solely based on commercial considerations, the special privileges underlying them cannot alter the nature of it. If the exclusive rights or special privileges are not in violation of Article XVII in themselves, the using of them by a STE in accordance with commercial considerations is not a violation, either. If a privilege or a right cannot be used, it will not be a privilege or right at all.

- (c) **The STE charges a higher price in export market 1 than in export market 2 because the price-elasticity of import demand is lower in export market 1 than in export market 2.**

Answer

Yes, this is a commercial consideration. If the price-elasticity of import demand is lower in export 1, a STE could increase the price without running the risk of reducing demand. This is in conformity with the economic rational, and certainly the “commercial considerations” requirement.

- (d) **Same as (c), but the STE in addition extracts monopoly rents (price premiums) in both markers, which it could not do but for its exclusive right to export the product concerned (assume the STE’s product is perceived as superior in quality for instance such that there is no significant competition from other products).**

Answer

Yes, this is a commercial consideration. To pursue monopoly profit is a commercial consideration. To go a step further, to pursue monopoly rents by the using of the exclusive rights or special privileges is also a commercial consideration. If this line of reasoning was defied, the natural result would be that the granting of exclusive rights or special privileges is a violation of Article XVII in itself and Members would be deprived of the right to establish STEs.

4. Is the “commercial considerations” requirement in Article XVII:1(b) essentially intended to make sure that STEs use their special or exclusive privileges in such a way that their purchases of sales involving import or exports are made on terms which are no more advantageous for the STE than they would have been if the STE did not have any special or exclusive privileges? Or is the “economic considerations” requirement essentially intended to make sure that STEs act like rational economic operators, i.e., that in the ir purchase or sale decisions, they are guided only by the consideration of their own economic interest?

Answer to the first question

No. If this was the intention of Contracting Parties of GATT or Members of WTO, they would have made a clear and express statement in this regard in Article XVII. As to the meaning of the phrase “commercial considerations”, the interpretative notes and the drafting history indicate that

Article XVII:1 (b) would not preclude the charging by a state trading enterprise of different prices in different export markets;² nor consideration of the advantages of receiving a “tied loan” in connection with a purchase.³ Moreover, it was understood that the phrase “customary business practice” as used in Article XVII:1 (b) was intended to cover business practices customary in the respective line of trade.⁴

Answer to the second question

Yes. This illustrates the proper interpretation of “commercial considerations”.

5. Do the “commercial considerations” requirement in Article XVII:1 (b) vary depending on what type of entity (e.g., co-operatives, share-capital corporations, etc.) is conducting the purchase or sales operations?

Answer

First, we think that it is clear that no matter what type of entity a STE is, it should make purchases and sales in accordance with commercial consideration. Second, the elements of “commercial considerations” or the weight of each element to be given to may vary with the type of entities conducting the purchase or sales operation. Article XVII:1(b) provides that a STE shall “...make any such purchases or sales solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale...” This provision lists some elements of commercial considerations and allows a STE to consider “other conditions of purchase or sale”. Different type of commercial entities may take different elements into account in their operation or give different weight to each of the element listed. The standard should be that a STE shall take the same considerations into account as what a private-sector enterprise of the same type of entity should do. If in private sector a cooperative and a share holding company have different considerations in the ordinary course of their business, then STEs in form of cooperative or in form of share holding company may do the same thing, which is not against the “commercial considerations” requirement provided in Article XVII:1.

6. Pursuant to Article XVII:1(a), each Member undertakes that its STEs “shall” act in a specified manner. Please explain the meaning and usage of the term “shall” in Article XVII:1(a). In particular, what if any, difference in meaning would there be if Article XVII:1(a) had said that each Member “undertakes” that as STEs “will” act in the specified manner?

Answer

According to Black’s Law Dictionary, “shall” ,when used in statutes, contracts or the like, is “generally imperative or Mandatory”, “and in common or ordinary parlance, and in its ordinary signification, the term “shall” is a word of command, and one which has always or which must be given a compulsory meaning; as denoting obligation”, but “it may be construed as merely permissive or directory (as equivalent to ‘may’), to carry out the legislative intention and in case where no right or benefit to any one depends on its being taken in the imperative sense, and where no public or private right is impaired by its interpretation in the other sense.”⁵ In the same dictionary, “will” is “an auxiliary verb commonly having the mandatory sense of “shall” or “must.”⁶ We can see that in legal

² Interpretative note to Article XVII:1.

³ Interpretative note to Article XVII:1(b).

⁴ Analytical index, op. cit., 477.

⁵ Black’s Law Dictionary (1979), at 1233.

⁶ Id, at 1433.

uses, these two words carry almost the same meaning. In the context of Article XVII:1, with the preceding word “undertake”, these two words will not make any significant differences. Members undertake that a STE “shall” act in a specified manner or “will” act in this kind of manner both means that Members shall assume responsibilities if a STE they established fails to act in this specified manner.

7. Do the third parties agree with the United States’ view that Article XVII:1(a) imposes an obligation on Members to take affirmative measures to ensure that their STEs comply with the Article XVII:1(a) standards? [US first written submission, paras.50-52,67-69]

Answer

No. We agree to Canada’s view that the obligation of Members under this provision is an “obligation of result”. We think that GATT Article XVII does not impose an obligation on governments to involve in STE’s everyday operation. If a government were imposed such an obligation, it would be too burdensome and not practical. Moreover, such an obligation runs afoul of the objective of GATT Article XVII.

8. With references to Para 55 of the US first written submission, do the third parties agree that Article XVII:1(a) prohibits the CWB from “making use of its exclusive privileges to discriminate in its terms of sale between export markets and the Canadian domestic market”?

Answer

No. Our position is that no support could be found for the US allegation in this regard neither in Article XVII:1(a) nor in the whole context of Article XVII.

MEASURES RELATING TO TREATMENT OF IMPORTED GRAIN

9. With reference to paras 207, 217 and 279 of Canada’s first written submission, is it correct that Article III:4 of the GATT 1994 does not apply to laws affecting the transportation of goods in-transit?

Answer

It is correct that Article III:4 does not apply to laws affecting goods in-transit. The text of Article III:4 is that:

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

Therefore, Article III:4 applies only to laws affecting the imported goods.

Moreover, Article V of GATT 1994 provides for the freedom of transit of goods, and also vessels and other means of transport. There is no point of stretching Article III:4 to cover the transit goods.

ANNEX A-5

RESPONSES OF THE EUROPEAN COMMUNITIES TO QUESTIONS POSED IN THE CONTEXT OF THE FIRST SUBSTANTIVE MEETING OF THE PANEL

(24 September 2003)

I. MEASURES RELATING TO EXPORTS OF WHEAT

For all Third Parties:

1. Once a panel has determined that, in making certain export sale(s), an STE did not act in conformity with the standards set forth in Article XVII:1(b), can the panel find a violation of Article XVII:1 on that basis alone, or is it necessary for the panel to make a separate and additional determination whether, in making the export sale(s) in question, the relevant STE did not act in a manner consistent with the general principles of non-discriminatory treatment.

According to the wording of Article XVII:1(b), the provisions of subparagraph (a) "shall be understood" to require that STEs make any purchases or sales solely in accordance with commercial considerations. In the view of the EC, a finding that the standard of subparagraph (b) has not been met automatically entails the finding that subparagraph (a) has been violated. This means that if a panel establishes that an STE has not acted in accordance with commercial considerations in its purchases or sales, it may make a finding of a violation on that basis alone.

The EC would like to add that, as it has set out previously¹, it considers that subparagraphs (a) and (b) of Article XVII:1, even though interrelated, are not identical in scope. This means that inversely, if a Panel does not find a violation of the standard of Article XVII:1(b), it should still examine whether the STE has also complied with the standards of Article XVII:1(a).

2. The second clause of Article XVII:1(b) requires STEs to afford enterprises of other Members adequate opportunity "to compete for participation in such purchases or sales".

- (a) **Is the expression "such purchases or sales" a reference to a given STE's "purchases or sales involving either imports or exports", *i.e.*, the expression used in Article XVII:1(a)? In other words, is "such purchases" a reference to a given STE's purchases abroad (imports) and "such sales" a reference to a given STE's sales abroad (exports)?**

The EC considers that the term "such purchases or sales" in subparagraph (b) is to be considered as a reference to the term "purchases or sales involving either imports or exports" in subparagraph (a). However, the EC would like to specify that in its view, sales may also be said to involve "imports" if the product sold has previously been imported, and purchases may be said to involve "exports" if the products purchased are subsequently exported. In this way, the term

¹ EC Third Party Submission, para. 9.

"purchases or sales involving either imports or exports" encompasses the entire trading activity of an STE.

- (b) **Taking the case of an export STE like the CWB, are the relevant "enterprises" of other Members (i) the enterprises which are interested in buying wheat from the CWB (*i.e.*, wheat buyers); (ii) those enterprises competing with the CWB for sales to the same wheat buyers (*i.e.*, wheat sellers) or (iii) other enterprises?**

Article XVII:1(b) does not further define the "enterprises" of the other contracting parties to which "adequate opportunities" must be afforded. For this reason, the EC considers that the relevant enterprises can be (i) the enterprises which are interested in buying wheat from the CWB (*i.e.*, wheat buyers); (ii) those enterprises competing with the CWB for sales to the same wheat buyers (*i.e.*, wheat sellers), or also (iii) other enterprises which offer wheat to the CWB for sales abroad.

3. Assume a Member has an export STE which has the exclusive right to sell a particular agricultural product for export and domestic consumption. Please indicate whether in the following situations the STE would be making its export sales in accordance with "commercial considerations" within the meaning of Article XVII:1(b):

- (a) **The STE charges a lower price in export market 2 than in export market 1 because market 2 is contested by a supplier who benefits from an export subsidy, while market 1 is not.**

The export subsidy would constitute a factor influencing supply which is outside the control of the STE, and which will tend to lower market price in market 2. By charging a lower price in market 2, the STE would therefore be acting in accordance with commercial considerations.

- (b) **The STE charges a lower price in export market 2 than in export market 1 because market 2 is a priority market for the STE (e.g., due to expected growth in import demand) and the lower price is intended to deter other exporters from contesting export market 2. The price charged by the STE in export market 2 would not or could not have been charged in the absence of the special or exclusive privileges enjoyed by the STE.**

The term "commercial considerations" should be defined in the light of normal commercial behaviour. Normal commercial behaviour involves the setting of prices on the basis of the conditions of supply and demand, which are taken as given constraints. Setting prices below normal market levels in order to exclude competitors and thereby influencing the constraints on the market cannot be regarded as normal commercial behaviour. This is independent of whether the prices could have been charged in the absence of the special and exclusive privileges of the STE.

- (c) **The STE charges a higher price in export market 1 than in export market 2 because the price-elasticity of import demand is lower in export market 1 than in export market 2.**

The price elasticity of import demand constitutes an external factor outside control of the STE. By charging a higher price in export market 1 than in export market 2, the STE would therefore act in accordance with commercial considerations.

- (d) **Same as (c), but the STE in addition extracts monopoly rents (price premiums) in both markets, which it could not do but for its exclusive right to export the product concerned (assume the STE's product is perceived as superior in quality for instance, such that there is no significant competition from other products).**

The EC considers that it must be distinguished whether the STE is able to charge premium prices because its product is perceived as superior in quality to other products, or merely because of its exclusive rights. If the price premiums are due to superior quality of the product, then the STE acts in accordance with normal considerations in charging a higher price. In contrast, if the STE charges premium prices in the absence of an objective justification, such as superior quality, it no longer acts as a participant subject to the constraints of the market, and does not act in accordance with commercial considerations.

4. Is the "commercial considerations" requirement in Article XVII:1(b) essentially intended to make sure that STEs use their special or exclusive privileges in such a way that their purchases or sales involving imports or exports are made on terms which are no more advantageous for the STE than they would have been if the STE did not have any special or exclusive privileges? Or is the "commercial considerations" requirement essentially intended to make sure that STEs act like rational economic operators, *i.e.*, that, in their purchase or sale decisions, they are guided only by the consideration of their own economic interest?

Article XVII does not affect the right of WTO Members to establish STEs and to endow them with special and exclusive rights. Therefore, the mere use of such special rights does not constitute a violation of Article XVII:1(b). However, the EC also considers that "commercial considerations" cannot be regarded as purely requiring economic rationality. Rather, "commercial considerations" should be defined in terms of normal commercial behaviour of economic actors subject to market constraints.

5. Is the term "commercial considerations" a concept which is neutral in its application? Or do the "commercial considerations" vary depending on what type of entity is conducting the purchase or sales operations?

In the view of the EC, the term "commercial considerations" is a concept which refers to normal commercial behaviour of a market participant subject to the constraints of the market.

6. Pursuant to Article XVII:1(a), each Member undertakes that its STEs "shall" act in a specified manner. Please explain the meaning and usage of the term "shall" in Article XVII:1(a). In particular, what, if any, difference in meaning would there be if Article XVII:1(a) had said that each Member "undertakes" that its STEs "will" act in the specified manner?

In the view of the EC, Article XVII:1(a) establishes, for the Member concerned, an obligation of result with respect to the behaviour of the STE it has established. This means that if the STE acts in a manner not in accordance with Article XVII, the Member will be in violation of Article XVII:1(a), regardless of whether and how the Member involved has influenced the behaviour of its STE.

In the view of the EC, the terms "shall" or "will" both express a firm commitment. There would therefore not be any difference in meaning if Article XVII:1(a) used the term "will" instead of "shall".

7. Do the third parties agree with the United States' view that Article XVII:1(a) imposes an obligation on Members to take affirmative measures to ensure that their STEs comply with the Article XVII:1 standards? (US first written submission, paras. 50-52, 67-69)

In the view of the EC, Article XVII:1(a) establishes an obligation of result with respect to the behaviour of STEs. In contrast, Article XVII:1(a) does not specify specific measures which the WTO

Member. However, if the WTO Member fails to take the necessary measures, and the STE acts in violation of Article XVII:1, it will be responsible for this violation.

8. With reference to para. 55 of the US first written submission, do the third parties agree that Article XVII:1(a) prohibits the CWB from "making use of its exclusive privileges to discriminate in its terms of sale between export markets and the Canadian domestic market"?

The EC considers that if the CWB discriminates in its terms of sale between exports markets, and such discrimination is not justified by commercial considerations, it acts in violation of Article XVII:1(b). This is explicitly confirmed by the last paragraph of the Ad Note to Article XVII:1. In the view of the EC, it is not decisive whether the discrimination is made possible by the exclusive privileges of the CWB or not.

II. MEASURES RELATING TO TREATMENT OF IMPORTED GRAIN

For all Third Parties:

9. With reference to paras. 207, 217 and 279 of Canada's first written submission, is it correct that Article III:4 of the GATT 1994 does not apply to laws affecting the transportation of goods in-transit?

The EC notes that Article III:4 establishes an obligation of national treatment in respect of laws, regulations and requirements affecting the "internal sale, offering for sale, purchase, transportation, distribution or use". In contrast, the transit of goods across the territory of a party is governed by the disciplines of Article V GATT. The EC therefore agrees that Article III:4 does not affect the transportation of goods in transit.

For the EC:

10. With reference to footnote 11 of the EC's written submission, please indicate what types of trade-distorting conduct would *not* be covered by Article XVII.

The EC meant to recall that Article XVII does not affect the right of WTO Members to establish STEs. Accordingly, trade distortions which result directly from the establishment of the STE, but are not attributable to any specific trade-related conduct of the STE, are not contrary to Article XVII:1.

12. Could the EC please elaborate on its arguments in paragraph 37 of its third party submission relating to claims made under GATT Article III:4. In particular, why does the EC state that "some US wheat may not be like Canadian wheat, for instance if it is of a different variety, grade, and quality" while at the same time arguing that domestic and imported wheat must be "like" because such wheat "but for the difference in origin, is otherwise identical."

The EC intended to clarify that wheat of a certain variety, grade, or quality, is not "like" wheat which is of a different variety, grade, or quality. The EC therefore discussed the Canadian segregation measures only to the extent that they concern wheat of identical variety, grade, and quality. Under this hypothesis, however, the EC considers that Canadian and foreign wheat must be considered as like products, regardless of origin.

ANNEX A-6

RESPONSES OF THE SEPARATE CUSTOMS TERRITORY OF TAIWAN, PENGHU, KINMEN AND MATSU TO QUESTIONS POSED IN THE CONTEXT OF THE FIRST SUBSTANTIVE MEETING OF THE PANEL

(24 September 2003)

Question 1

1. Article XVII:1(b) of GATT 1994 provides in part that “[t]he provisions of subparagraph (a) of this paragraph shall be understood to require that such enterprises shall, having due regard to the other provisions of this Agreement, make any such purchases or sales solely in accordance with commercial considerations...” A literal reading of this provision suggests that the provision is not intended as a separate independent obligation on Members. Instead, it serves as a further elaboration of the obligation under 1(a). By examining the scope established under 1(b), a determination can then be made whether a violation of the obligation under 1(a) has occurred. In other words, if an STE does not make its purchases or sales in accordance with commercial considerations, the Member in question would be in violation of 1(a), as interpreted by 1(b).

2. Previous Panel rulings support our reading. In *Korea-Measures Affecting the Import of Fresh, Chilled and Frozen Beef*, the Panel clarified the relationship between non-discrimination under subparagraph (a) and commercial considerations under subparagraph (b). It stated that,

[t]he list of variables that can be used to assess whether a state-trading action is based on commercial consideration (prices, availability etc.) are to be used to facilitate the assessment whether the state-trading enterprise has acted in respect of the general principles of non-discrimination. A conclusion that the principle of non-discrimination was violated would suffice to prove a violation of Article XVII; similarly, a conclusion that a decision to purchase or buy was not based on ‘commercial considerations’, would also suffice to show a violation of Article XVII. (Korea Beef, para. 757.)

In *Canada-Administration of the Foreign Investment Review Act* of 1984, the panel also confirmed that Article XVII:1(b) is not to establish an independent obligation. Instead, it is to interpret the scope of the non-discrimination principle under Article XVII:1(a). The panel report of this case states that,

[t]he fact that sub-paragraph (b) does not establish a separate general obligation to allow enterprises to act in accordance with commercial considerations, but merely defines the obligations set out in the preceding sub-paragraph, is made clear through the introductory words ‘The provisions of sub-paragraph (a) of the paragraph shall be understood to require...’ (L/5504, adopted on 7 February 1984, 30S/140, 163, para. 5.16.)

The panel should be in a position to find a violation of Article XVII:1 by the said Member on the basis of non-conformity with “commercial consideration” alone.

Question 2

3. Article XVII:1(a) of the GATT regulates purchases or sales involving either imports or exports of STEs. If an STE’s activities do not have anything to do with import or export, it should not be within the scope of the provision of Article XVII of the GATT. Since subparagraph (b) is a further elaboration of subparagraph (a), the phrase “such purchases or sales” refers to purchases or sales involving exports or imports, as indicated in subparagraph (a).

4. Given above interpretation, the CWB itself as an STE would have to provide enterprises of other Members opportunities with regard to its purchases or sales, taking into account customary business practice. The enterprises of other Members include the buyers of wheat and the sellers of wheat in so far as they seek participation in the purchases and sales involving the STE in question.

Question 3

5. There is no definition of the phrase “commercial considerations” either in Article XVII or in other GATT provisions. The question of whether an STE is making decisions on purchases and sales based on commercial consideration must be assessed on a case by case basis. In particular, the structure of the markets, competitions, and other situations particular to the market would determine whether the STE is acting in accordance with commercial considerations.

6. Furthermore, considerations on pricing policy by any enterprise is closely related to the dynamics of competition within a relevant market. How an enterprise determines its behaviour *vis-à-vis* its pricing involves complex considerations such as, *inter alia*, market structure, the intensity of price competition, supply and demand, the value provided to the enterprise in matching/undercutting the prices of competitors, etc. Is an STE selling its excessive stock at a substantial discount in order to minimize losses acting in accordance with commercial considerations? The answer could be in the affirmative. Therefore, the question of whether an STE acts in a manner solely in accordance with commercial considerations can only be answered by reviewing the circumstances surrounding the action in question.

7. With respect to the factors of supply and demand, Ad Article XVII states that,

[t]he charging by a state enterprise of different prices for its sales of a product in different markets is not precluded by the provisions of this Article, provided that such different prices are charged for commercial reasons, to meet conditions of supply and demand in export markets.

Thus the condition of supply and demand is another one of the factors to consider when deciding whether commercial considerations have been followed.

8. In any event, it is for the complaining Member to prove that the “inconsistent act” complained of lacks the requisite commercial considerations. We do not consider it appropriate to base an analysis of the term “commercial considerations” purely on hypothetical scenarios which seem to focus solely on the pricing policy of an STE.

9. Nevertheless, it may still be useful to apply the above explanations to see whether the given factors are the possible bases of charging different prices. With regard to the first hypothetical question, the competitive structure of the two markets are different. This “could” be a valid basis for the STE to apply different prices in each market. In other words, the different prices do not

automatically mean that the STE did not act in accordance with commercial considerations. For the second through fourth hypothetical questions, we recognize that the STE might abuse its market position in deciding the sale prices. However, since differential pricing could be a legitimate way of generating of profits, we might not be able to determine whether the STE is setting its prices in accordance with commercial considerations purely by fact that the STE uses different prices to compete in the relevant markets.

Question 5

10. We do not consider the type of entity conducting the sale and purchase to be relevant. The Panel should make its determination on a case-by-case basis, taking into account the particular circumstances of the markets in question.

Question 7

11. As stated in our Third Party Submission, Article XVII: 1(a) poses only an obligation of result the means of which is the prerogative of the Member concerned.