

## Canada's dairy tariff rate quotas under fire again: New Zealand and the U.S. challenge Canada's import controls

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Canada's regulation of its dairy industry — specifically, its supply management system for dairy (which uses production controls and tariffs to protect domestic dairy farmers) — has been a long-standing point of contention with Canada's trading partners. In particular, Canada's application of import controls, known as "tariff rate quotas" (TRQs), has raised concern among other dairy producers, notably the U.S. and New Zealand.

In response to a challenge by the U.S. under the Canada-United States-Mexico Agreement (CUSMA), Canada [announced](#) the publication of new CUSMA dairy TRQ policies on May 16, 2022. Shortly after the announcement, both New Zealand and the U.S. announced separate challenges to Canada's practices regarding dairy TRQs under their respective trade agreements with Canada. This Update will explain the new policies, as well as the challenges being brought by the U.S. and New Zealand.

### Background: TRQs and the first U.S. challenge

As we wrote about in an [Update](#) earlier this year, Canada's supply management system for dairy is composed of three "pillars": (1) controlled production; (2) pricing mechanisms; and (3) import controls (TRQs). The TRQs establish a limit on the quantity of a product that may be imported at a lower rate of duty, and apply a preferential rate of duty to the "in-quota" quantity of imports of a certain product or category of products. Though the TRQ does not impose a limit on the amount of a product that may be imported, a different (higher) tariff rate is applied to imports beyond that "in-quota" quantity. Canada sets TRQs through free trade agreements to limit the volume of foreign dairy products entering the Canadian market, and maintains 14 dairy TRQs under Chapter 2 of CUSMA.

The allocation of these TRQs has been a sore point for Canada's trading partners. Specifically, as its chosen TRQ allocation method Canada reserves between 85% and 100% of each TRQ for domestic producers. Other TRQ applicants could then apply for the remaining percentage of the TRQ. Where an importer (whether a processor or otherwise) cannot utilize a TRQ, it will likely be subject to a prohibitive over-quota tariff rate.

In May 2021, the U.S. [advanced](#) the first state-to-state dispute under CUSMA when it called for the establishment of a dispute resolution panel to review Canada's practice of reserving 85-100% of the TRQs exclusively for processors. A dispute resolution panel (the Panel) was convened to hear the dispute. The basis of the dispute was that Canada's practice of allocating TRQs was inconsistent with its obligations under CUSMA. In a [decision made public \[PDF\]](#) on January 4, 2022, the CUSMA Panel determined that Canada was in breach of its CUSMA commitments by reserving TRQs for the exclusive use of domestic dairy processors.

## Canada changes dairy tariff rate quota policies following CUSMA Panel's report

In response to the Panel's decision, Canada published new dairy TRQ policies under CUSMA on May 16, 2022. Under the new CUSMA dairy TRQ policies, Canada has

- removed all allocation holder pools under all CUSMA dairy TRQs
- included distributors as eligible under the CUSMA Industrial Cheeses TRQ

On the same day as the announcement of the new TRQ policies, Global Affairs Canada opened the application period for the 2022-2023 dairy year TRQs and the previously unallocated quota under the 2022 CUSMA calendar year dairy TRQs. The application period started on May 16, 2022; the deadline to apply is June 15, 2022.

### The U.S. responds

The U.S. does not appear to be satisfied with Canada's new policies. On May 25, 2022, the U.S. announced that the U.S. is, for the second time, requesting dispute settlement consultations with Canada under CUSMA to address dairy restrictions by Canada that are allegedly contrary to its CUSMA commitments.

Specifically, the U.S. is again challenging the TRQ allocation measures, and challenging Canada's failure to fully allocate its annual dairy TRQs (and instead "parceling out a few months' quota at a time"). The U.S. takes the position that the new dairy TRQ policies are not consistent with CUSMA — that "[t]hrough these measures, Canada undermines the market access that it agreed to provide under CUSMA." The administration has signaled that obtaining access to Canada's dairy market "remains a top priority" and that they are considering "all options to achieve this objective."

While it remains to be seen how the issue will be resolved (and whether another formal CUSMA dispute resolution panel will even be convened), it appears clear that questions remain regarding the implementation of CUSMA, and that tensions between the trading partners are elevated.

### New Zealand enters the ring

Disputes relating to dairy TRQs are not limited to Canada and the U.S. The first dispute under the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (the CPTPP) also concerns Canada's implementation of TRQs under the agreement.

As part of the CPTPP, Canada agreed to allow trading partners tariff-free access to its market for a certain amount of imported dairy. However — similar to its practice of allocating TRQs to domestic processors under CUSMA — much of the quota for importing product under the CPTPP TRQs was allocated to Canadians, limiting partners like New Zealand's ability to utilize the TRQs. In a statement, New Zealand's Minister of Agriculture said that the manner in which Canada has implemented dairy TRQs is "inconsistent with its obligations under CPTPP", adding, "Many of Canada's dairy TRQs remain unfilled and this represents a tangible loss to New Zealand's dairy exporters." According to New Zealand, the estimated value of this lost market access is approximately \$68 million over the first two years, and is expected to increase year-over-year as the size of these quotas grow under CPTPP.

On May 12, 2022, New Zealand formally launched a dispute under the CPTPP, requesting

consultations with the Canadian Government concerning Canada's implementation of its obligations regarding dairy TRQs. If the parties fail to resolve the dispute through consultations, New Zealand could request the establishment of a dispute settlement panel as early as July 11, 2022.

This is not the first time New Zealand has taken Canada to task over its regulation of the dairy industry. In 1997, New Zealand requested consultations with Canada regarding an alleged dairy export subsidy scheme referred to as the "special milk classes scheme". In that instance, New Zealand contended that the Canadian "special milk classes scheme" was inconsistent with Article XI of the GATT 1994<sup>[1]</sup> and Articles 3, 8, 9 and 10 of the Agreement on Agriculture.<sup>[2]</sup> In the Dispute Settlement Body (DSB) Panel Report released in May 1999, the DSB concluded that the measures were inconsistent with Canada's obligations under Article II:1(b) of the GATT 1994 and Articles 3.3 and 8 of the Agreement on Agriculture. In May 2003, Canada and New Zealand informed the DSB that they had reached a mutually agreed-upon solution.

## Key takeaways

Canada's approach to dairy imports, including its supply management system and application of TRQs under various agreements, has been a longstanding sore spot for its trading partners. Parties to various multilateral free trade agreements have demonstrated a clear willingness to challenge Canada's longstanding practices. Industry participants should expect Canada's policies in this area to evolve in some capacity; the speed at which this evolution occurs, and the specifics of what it looks like, remain to be seen. One factor likely to impact this evolution is whether Canada decides to resolve disputes with the U.S. and New Zealand through consultations or through dispute resolution panels.

Industry participants should also expect the issue to remain politically charged. In drafting its policies in response to the CUSMA Panel's decision, the Canadian Government noted its displeasure with certain U.S. policies. Specifically Global Affairs Canada's Message to Industry regarding the TRQ policies notes

[G]iven Canada's deep concerns with the discriminatory electric vehicle tax credits proposed in the Build Back Better bill under U.S. Congress consideration, a decision regarding the potential allocation of the previously unallocated quota under the 2022 CUSMA calendar year dairy TRQs will be taken as the issue evolves, but not later than July 31. Any previously allocated and unused quota under the 2022 CUSMA calendar year dairy TRQs will remain valid until December 31, 2022.

As "America-first" sentiment continues to permeate U.S. trade policy, such statements will likely continue to inform policy decisions on both sides of the border.

## Conclusion

While the CUSMA Panel decision may provide some insight into how dispute resolution panels convened under CUSMA (and the CPTPP, which is similarly drafted) will interpret Canada's dairy TRQ practices, the ways governments will give effect to such panel decisions is currently unknown. Participants in the dairy industry (including domestic and importers) should expect for this area to continue to evolve and for disputes to be impacted by various political objectives.

Osler's International Trade and Investment Law team has experience in various forms of trade and investment disputes, as well as matters relating to international trade regulations,

government measures, and actions and policies that impede access to Canadian and foreign markets. The International Trade and Investment team works hand-in-hand with Osler's Agribusiness experts. Consisting of lawyers drawn from practice areas across the firm, Osler's Agribusiness team provides technical legal advice, practical business guidance and government relations and strategic communications advisory services on the multi-faceted Agribusiness, Ag Inputs and Agtech sectors. Together, our interdisciplinary team provides various services and is well-positioned to give expert advice on how best to navigate the challenges presented by this evolving landscape.

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[1] GATT 1994: General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1867 U.N.T.S. 187, 33 I.L.M. 1153 (1994).

[2] Agreement on Agriculture, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1867 U.N.T.S. 410.