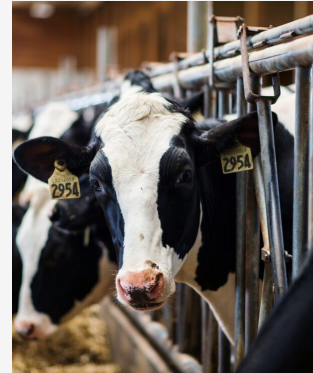


CPTPP panel releases decision on Canada's practices regarding allocation of dairy tariff rate quotas under Agreement

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The regulation of Canada's dairy industry continues to be a point of contention between Canada and its trading partners. Specifically, Canada's practices regarding the allocation of tariff rate quotas (TRQs) for various dairy products have repeatedly come under scrutiny and are now the source of the first disputes under two of Canada's key free trade agreements: the Canada–United States–Mexico Agreement (CUSMA) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (the CPTPP).

As we wrote about in our previous post, [New Zealand formally launched a dispute](#) under the CPTPP in May 2022, requesting consultations with the Canadian government concerning Canada's implementation of its obligations regarding dairy TRQs. Following these consultations, New Zealand requested the establishment of the first dispute resolution panel convened under the CPTPP (the CPTPP Panel) in November 2022. The CPTPP Panel released its [Report](#) [PDF] on September 5, 2023, concluding that certain of Canada's practices regarding the allocation of dairy TRQs violate its commitments under the CPTPP.

Background

The dispute arose due to Canada's "supply management" system used to regulate the Canadian dairy industry. (For details on this supply management system, see our previous [post](#).) Essentially, this system is composed of three "pillars": controlled production, pricing mechanisms and controlled imports. Controlled imports allow Canada to limit the volume of foreign dairy products entering the Canadian dairy market.

TRQs are a mechanism which allows Canada to control imports. TRQs were agreed to by the Parties to the CPTPP, and are established to limit the quantity of a product that may be imported at a lower rate of duty (the "in-quota" amount). A higher (often prohibitive) tariff rate is applied to imports of the product beyond the "in-quota" amount. Canada administers these TRQs through an import licensing system; shipment-specific imports are issued for all imports of "in-quota" goods.

The dispute and the CPTPP Panel's decision

Canada's process for issuing these permits — and thereby allocating who may import the goods at the preferential tariff rate — was the subject of New Zealand's complaint. Canada's TRQs have been underutilized since the CPTPP has been in effect, with the percentage of the quotas filled by imports being 10% or lower for 13 of Canada's 16 dairy TRQs.^[1] Nine of the 13 TRQs had no imports at all.^[2]

While the in-quota volumes of each TRQ are negotiated as part of the CPTPP, the methods by which the TRQs are allocated are determined by each Party. Canada's allocation mechanism is based on a pooling system that reserves specific percentages of each of the 16 dairy TRQs provided in the CPTPP for "processors", "further processors" and "distributors". The percentages reserved for each group or pool are defined in Canada's Notice to Importers (the Notices) for each of the 16 TRQs, and published by Global Affairs Canada. The allocations in the Notices reserve 80–85% of all dairy TRQs for processors, 0–20% for further processors and 0–15% for distributors, depending on the particular TRQ.^[3]

Essentially, New Zealand argued that through its allocation practices, Canada was channeling TRQ access away from Canadian importers who could use the preferential tariff rate to import dairy goods from New Zealand, and instead gave the quota to domestic processors, thereby preventing New Zealand exporters from being able to utilize the TRQs and violating various obligations under the CPTPP. The CPTPP Panel was specifically asked to determine whether Canada's allocation measures, as set forth in the Notices, are consistent with the following obligations of the Parties under the CPTPP (contained in articles 2.28 through 2.30):

- to "ensure that ... any person of a Party that fulfills [Canada's] eligibility requirements is able to apply and to be considered for a quota allocation under the TRQ" and to ensure that the allocation system does not "limit allocation to processors"
- to ensure "fair and equitable" procedures for administering TRQs, and to administer TRQs in a manner that allows importers the opportunity to utilise TRQ quantities fully
- not to "introduce a new or additional condition, limit or eligibility requirement on the utilisation of a TRQ ... beyond those set out in [Canada's] Schedule to Annex 2-D (Tariff Commitments)"
- to "ensure that ... each allocation is made in commercially viable shipping quantities and, to the maximum extent possible... in the amounts that importers request"
- to "ensure that ... if the aggregate TRQ quantity requested by applicants exceeds the quota size, allocation to eligible applicants shall be conducted by equitable and transparent methods"

The CPTPP Panel's decision turned largely on the interpretation of the phrase "to limit an allocation to processors" (in article 2.30(1)(b)), referred to as the "Processor Clause". According to New Zealand, the phrase should be interpreted to mean that if a Party limits access to one, several or all available allocations, they are in breach of their obligations under the CPTPP. As Canada indisputably reserves the vast majority of each of the dairy TRQ's volumes to processors, it was in violation of its obligations.

Canada disputed this interpretation, arguing that the Processor Clause prohibits a Party from confining the ability to obtain an allocation to processors entirely. Simply, this practice of "pools" — or reserving a portion of the TRQ for processors — is not a violation of the agreement, as every eligible non-processor that applies is eligible to receive an application.

The CPTPP Panel ultimately determined that Canada was in breach of its commitments under the CPTPP. Specifically, reserving access to some or all of its dairy TRQ allocations only to processors is inconsistent with a number of Canada's obligations under the CPTPP.^[4] Further, the CPTPP Panel found that Canada's "pooling system" operates to limit the opportunity for otherwise eligible applicants to use the TRQs fully. Importantly for Canada, the CPTPP Panel did recognize Canada's discretion to set TRQ allocation policies in accordance with its obligations under the CPTPP, including determining who may obtain an allocation.

The Parties now have 45 days from the CPTPP Panel's Report to try to agree on a reasonable period of time to eliminate any non-conformity.

A pattern emerging?

As we have previously discussed, a CUSMA Panel convened last year resolved a nearly identical claim brought by the United States under CUSMA, reaching a strikingly similar conclusion. The CPTPP Panel's Report noted the CUSMA decision was "informative", but not binding on the CPTPP Panel. The CPTPP Panel's decision — while resulting in a similar outcome to the CUSMA Panel's decision — was decided through an independent assessment. In response to the CUSMA Panel's decision, Canada took steps to remedy the U.S.'s concerns, changing its allocation practices with respect to dairy TRQs. The U.S. was not satisfied with Canada's new policies, and has requested a second panel be convened to hear additional U.S. concerns.

Australia, Japan, Mexico, Peru and Singapore joined the dispute as third parties, a sign that other of Canada's trading partners may echo similar concerns.

Key takeaways

The governments of both New Zealand and Canada have released statements deeming the CPTPP Panel's decision a "win" for their respective interests. In her press release, Minister Ng emphasized the CPTPP Panel's recognition of Canada's dairy supply management system, noting that Canada "will not negotiate these allocations with countries who seek to weaken Canada's supply management system."

While noteworthy that the first disputes brought under both CUSMA and the CPTPP concern Canada's dairy TRQ allocation practices — and that the U.S. has brought a second, similar dispute under CUSMA — it remains to be seen how Canada's practices will evolve and what future disputes may look like. So far, the Government of Canada has shown no willingness to move away from the supply management system. Investors should expect for future disputes to be resolved in a similar manner, and for disputes to be impacted by various political objectives. Both investors and governments will continue to adapt and interpret the agreements as time goes on. Osler's International Trade and Investment and Agribusiness teams will continue to monitor developments.

[1] Canada – Dairy Tariff Rate Quota Allocation Measures (CDA-NZ-2022-28-01), Final Panel Report [PDF], September 5, 2023, at para. 30 ["Panel Report"].

[2] Panel Report, at para. 30.

[3] Panel Report, at para. 24.

[4] Panel Report, at para. 85.