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# The *Sports Illustrated Canada* Controversy: Canada “Strikes Out” in Its Bid to Protect Its Periodical Industry from U.S. Split-Run Periodicals

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Canada and the United States share a long history based on their similar economic interests. Since the 1950s, a tension has evolved between the two relating to trade in cultural goods and services.<sup>1</sup> Recently, this tension was illustrated through disputes on issues ranging from broadcasting<sup>2</sup> to split-run periodicals.<sup>3</sup> In the *Sports Illustrated Canada* dispute, Time Warner, Inc. (“Time Warner”), the parent company of *Sports Illustrated*, violated the spirit of a Canadian law<sup>4</sup> prohibiting split-run periodicals<sup>5</sup> by publishing a split-run edition in Canada. In response, Canada passed an Excise Tax that made it prohibitively expensive for Time Warner to continue publishing the split-run edition.<sup>6</sup>

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1. See generally Andrew M. Carlson, Note, *The Country Music Television Dispute: An Illustration of the Tensions Between Canadian Cultural Protectionism and American Entertainment Exports*, 6 MINN. J. GLOBAL TRADE 585, 586-88 (1997) (discussing the background of the tension between domestic Canadian culture and entertainment and the export of U.S. culture and entertainment).

2. See *Two Senators Say U.S. Ready to Retaliate in Cable TV Fight with Canada*, INSIDE U.S. TRADE, Dec. 16, 1994, at 25. The United States and Canada recently settled the Country Music Television (“CMT”) dispute. *U.S. Drops Plan for Canada Sanctions After Commercial Deal Reached*, INSIDE U.S. TRADE, June 23, 1995, at 3. In the CMT dispute, the Canadian Radio-Television and Telecommunications Commission revoked CMT’s cable license in Canada in June 1994 and replaced CMT with a Canadian-owned country music television station. *Two Senators Say U.S. Ready to Retaliate in Cable TV Fight with Canada*, supra, at 3. Consequently, the United States threatened to retaliate if Canada failed to rectify the situation. *Id.* The dispute potentially could have resulted in a trade war in cultural products between the United States and Canada. The issue, though, was resolved when CMT and the Canadian-owned New Country Network reached a commercial agreement in which CMT was allowed to purchase a minority interest in the New Country Network. *U.S. Drops Plan for Canada Sanctions After Commercial Deal Reached*, supra, at 25.

3. See *infra* notes 74-100 and accompanying text.

4. See *infra* notes 64-67.

5. See *infra* notes 35-37, 78 and accompanying text.

6. See *infra* notes 80-100 and accompanying text.

The U.S. government responded by initiating dispute settlement proceedings in the World Trade Organization ("WTO").<sup>7</sup> The United States alleged that the Excise Tax and other related trade obstacles utilized by the Canadian government violated the General Agreement on Tariffs and Trade ("GATT").<sup>8</sup> The United States succeeded on all of its allegations.<sup>9</sup>

This dispute and its resolution raise a wide range of issues. First, they illustrate the interplay between the respective scopes of GATT and the General Agreement on Trade in Services ("GATS").<sup>10</sup> Second, they provide an opportunity to investigate the alternative courses of action Canada could have taken to resolve the *Sports Illustrated Canada* controversy. Third, they raise interesting questions about the possibly overlapping jurisdictions between the WTO and the North American Free Trade Agreement (NAFTA) and the resulting potential for forum shopping in international trade disputes. Finally, they underscore the continued tension between the two countries over the issue of cultural sovereignty.

This Note analyzes the decisions rendered by the Panel and Appellate Body in this dispute and offers possible GATT-consistent alternative courses of action for Canada. Part I of this Note discusses past and present Canadian-American trade relations and the events that led to the *Sports Illustrated Canada* controversy. Part II summarizes the decisions rendered by the Panel and the Appellate Body. Part III critiques those decisions, finding that, although they were mainly correct, important issues remain concerning how GATT will be applied to future disputes of this type. This Note posits that the international economic system must address issues of conflict between established multilateral agreements and emerging regional trade agreements that contain terms inconsistent with the past agreements and thus permit the use of past multilateral agreements to undermine regional agreements.

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7. See *infra* notes 101-07 and accompanying text; see also Agreement Establishing the World Trade Organization, opened for signature Apr. 15, 1994, 33 I.L.M. 1144 [hereinafter WTO].

8. See *infra* notes 108-10 and accompanying text; see also The General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194 [hereinafter GATT].

9. See *infra* notes 186-216 and accompanying text.

10. General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, LEGAL INSTRUMENTS - RESULTS OF THE URUGUAY ROUND vol. 31; 33 I.L.M. 44 (1994) [hereinafter GATS].

## I. BACKGROUND

## A. THE CANADA-UNITED STATES RELATIONSHIP

The United States is a daily presence in the life of every Canadian, through television programming, sports, and film. The common language and geographic proximity of Canada and the United States cause Canadians to view their culture as being very vulnerable to influence by U.S. cultural exports.<sup>11</sup> In addition, the large population disparity between the two countries further increases the fear of a U.S. cultural monopoly.<sup>12</sup> Many Canadians believe that an American value system and lifestyle would be imposed upon the Canadian people if Canada allowed unfettered free trade in cultural products with the United States.<sup>13</sup> Consequently, many Canadians ultimately view the cultural exemption contained in NAFTA<sup>14</sup> as a means of preserving their "national" sovereignty.<sup>15</sup>

The United States, on the other hand, has argued that "culture" is synonymous with entertainment and is, therefore, a

11. See John Herd Thompson, *Canada's Quest for Cultural Sovereignty: Protection, Promotion, and Popular Culture*, in NORTH AMERICA WITHOUT BORDERS? 269, 271 (Stephen J. Randall et al. eds., 1992). Eighty percent of the Canadian population lives within 100 kilometers of the U.S. border. *Id.* See also David Crane, *The New International Competitive Environment: A Canadian Perspective*, 21 CAN.-U.S. L.J. 15, 23 (1995). A national poll in Canada showed that 53% of Canadian residents were concerned that transborder information flows would undermine Canadian values and identity. *Id.* Moreover, 62% believed the government had a role to play in preventing this from occurring. *Id.*

12. Canada has a population of 30 million, compared to 266 million in the United States. First Submission of Canada in Canada—Certain Measures Concerning Periodicals, 19XX WL 213177 (W.T.O.) (Sept. 26, 1996), ¶ 20, n.13 [hereinafter First Submission of Canada].

13. See Graham Carr, *Trade Liberalization and the Political Economy of Culture: An International Perspective on FTA*, CAN.-AM. PUB. POL'Y NO. 6, June 1991, at 1, 26 (explaining that the free flow of information is a way of imposing value systems on vulnerable societies). See also Clint N. Smith, Note, *International Trade in Television Programming and GATT: An Analysis of Why the European Community's Local Program Requirement Violates the General Agreement on Tariffs and Trade*, 10 INT'L TAX & BUS. LAW 97, 133 (1993) (explaining that social scientists agree that the mass media are important vehicles for the acceleration of social change and the influencing of viewers' attitudes and behavior).

14. See *infra* notes 42-46.

15. See Carr, *supra* note 13, at 37 (explaining how the FTA, the predecessor to NAFTA, used the cultural exemption to protect Canada's cultural sovereignty).

tradable commodity.<sup>16</sup> In essence, American "culture" is an outgrowth of a country's economic machine and is just like any other big business.<sup>17</sup> Based on this economics-driven view of "culture," the U.S. government has argued that Canada's claim of cultural sovereignty is merely a vehicle for disguised protectionism.<sup>18</sup>

## B. THE CANADIAN AND U.S. PERIODICAL INDUSTRIES

Traditionally, Canada has exhibited concern about the inability of its periodicals to compete with the foreign periodicals sold in Canada. As a result, Canada has formed numerous commissions to examine the Canadian periodical industry and make recommendations on how to maintain its viability. In 1951, the Royal Commission on National Development in the Arts, Letters and Sciences was the first commission to examine the status of Canadian publications in relation to foreign publications circulated in Canada. It determined that periodicals were very influential in the development of "national understanding."<sup>19</sup> In 1961, the O'Leary Royal Commission concluded that Canadian periodicals could only survive if they were ensured a fair share of Canadian advertising revenues.<sup>20</sup> The O'Leary Commission recommended the enactment of Section 19 of the Income Tax Act<sup>21</sup> and an Import Ban<sup>22</sup> to protect the Canadian periodical industry. Both of these recommendations were subsequently enacted into law by the Canadian government.<sup>23</sup>

The Canadian periodical industry presently remains in a developmental stage.<sup>24</sup> It has not attained the maturity and

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16. Michael Braun & Leigh Parker, *Trade in Culture: Consumable Product or Cherished Articulation of a Nation's Soul?*, 22 DENV. J. INT'L L. & POL'Y 155, 165 (1993).

17. Carlson, *supra* note 1, at 614. The chief U.S. argument is that cultural exemptions are nothing more than protectionism. *Id.* See also Laurie Watson, *Cultural Sovereignty Issue*, UPI, June 29, 1986, available in LEXIS, News Library, UPI File. The fear of losing cultural sovereignty has little meaning in the U.S. *Id.* Indeed, during the talks leading up to the FTA, the chief U.S. delegate, Peter Murphy, was characterized as holding the view that "the vague nationalistic concept of cultural sovereignty is little more than hogwash." *Id.*

18. Watson, *supra* note 17.

19. A Question of Balance: Report of the Task Force on the Canadian Magazine Industry 77 (1994) [hereinafter Task Force Report].

20. *Id.* at 78.

21. *Id.*; see also *infra* notes 61-63 and accompanying text.

22. *Id.* at 78. See *infra* notes 64-71 and accompanying text.

23. *Id.* at 78.

24. Cathleen Cole, *Canadian Publishers Wary of Trade Pact: North American Free Trade Agreement*, FOLIO, Apr. 1, 1992, at 52.

economies of scale exhibited by its American counterpart.<sup>25</sup> In 1993, for example, the U.S. periodical industry was expected to generate revenues of \$22.7 billion.<sup>26</sup> In contrast, from 1991 to 1992, total sales for the entire Canadian periodical industry were only \$846.4 million.<sup>27</sup>

The financial position of the Canadian periodical industry is also unsecure. For example, in 1991 overall pre-tax profits earned by Canadian periodicals constituted only two percent of their total revenues.<sup>28</sup> Based on this small profit margin, the Canadian Magazine Publishers Association ("CMPA") has estimated that a mere three percent shift in Canadian advertising revenue to American publications would destroy the entire Canadian periodical industry's profits.<sup>29</sup> Therefore, Canada has used various subsidies<sup>30</sup> and tax provisions<sup>31</sup> in an effort to protect and maintain its periodical industry.

Circulation revenue and advertising revenue are the two main sources of income for Canadian periodicals.<sup>32</sup> Of these two sources, advertising revenue is clearly the more essential revenue component, accounting for sixty-four percent of revenue.<sup>33</sup> Circulation revenue, on the other hand, comprises only twenty-nine percent of the total revenue generated by Canadian periodicals.<sup>34</sup>

Imported split-run periodicals, under Canadian law, are particularly disfavored products because of their ability to offer significantly lower advertising rates. To create a split-run periodical, the publisher essentially separates ("splits") the editorial content and the advertising content of the periodical.<sup>35</sup> The periodical is then produced in two or more separate regional editions, with each sharing essentially the same editorial content but possessing entirely different advertising content. The pub-

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25. *Id.*

26. Task Force Report, *supra* note 19, at 21.

27. *Id.*

28. *Id.* at 92.

29. Richard Siklos, *Sports Illustrated Plan Stirs Murky Debate in Canada: "Canadian Edition a Threat to Domestic Industry?"*, FIN. POST, Jan. 26, 1993, at 11.

30. *See infra* notes 49-60 and accompanying text.

31. Income Tax Act, R.S.C., ch. 1, § 19 (1985, 5th Supp.) (Can.).

32. Task Force Report, *supra* note 19, at 9.

33. *Id.* at 12.

34. *Id.* at 9.

35. *See* First Submission of the United States of America in Canada—Certain Measures Concerning Periodicals, 1996 WL 900387 (W.T.O.) (Sept. 5, 1996), ¶ 5 [hereinafter First Submission of the U.S.].

lisher sells the advertising space to advertisers in the regional market in which the particular edition is circulated. Consequently, the advertising content in each regional edition is targeted specifically at the particular regional market in which the periodical circulates.<sup>36</sup>

The overriding incentive for publishing a split-run edition is profit. The publisher can earn a substantial profit from advertising revenue, while incurring few additional costs, in publishing a split-run edition. This occurs because the costs of producing the editorial content are absorbed by the production of the domestic edition.<sup>37</sup> The only cost incurred in producing the split-run edition is the cost of printing it. These low production costs allow split-run editions to offer substantially discounted advertising prices compared to non-split-run editions.

### C. THE FTA, NAFTA, AND GATT

The United States and Canada, the world's largest bilateral trading partners,<sup>38</sup> consummated the Canada-United States Free Trade Agreement ("FTA") on January 1, 1989.<sup>39</sup> This Agreement sought to eliminate, over a ten-year period, virtually all tariffs imposed on trade between the two countries.<sup>40</sup> Furthermore, it curtailed the implementation of nontariff barriers, implemented new dispute settlement procedures, and allowed expanded access to government procurement.<sup>41</sup>

Most importantly, though, it broadly exempted cultural products ("cultural exemption") from its general free trade provisions.<sup>42</sup> Under the FTA, cultural products included the publication, distribution, or sale of books, magazines, periodicals, or

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36. *Id.*

37. See First Submission of the U.S., *supra* note 35, ¶ 20 (citing Task Force Report, *supra* note 19, at 49) (explaining that a foreign publisher can easily make a profit because its fixed costs were recovered in its home market).

38. Frank James, *NAFTA Mostly a Success, Administration Reports Predictions Accurate, Daley Says; Expanding Pact Will Be Pushed*, CHI. TRIB., July 11, 1997. See generally Jean Raby, *The Investment Provisions of the Canada-United States Free Trade Agreement: A Canadian Perspective*, 84 AM. J. INT'L LAW 394 (1990) (discussing the trade relationship between the United States and Canada).

39. Canada-U.S. Free Trade Agreement, Dec. 22-23, 1987 and Jan. 2, 1988, Can.-U.S., 27 I.L.M. 281 [hereinafter FTA].

40. Fredric C. Menz & Sarah A. Stevens, *Editors' Introduction to Economic Opportunities in FREER U.S. TRADE WITH CANADA* 13, 22 (Fredric C. Menz & Sarah A. Stevens eds., 1991).

41. Raby, *supra* note 38, at 395.

42. FTA, art. 2005.

newspapers.<sup>43</sup> The cultural exemption permitted the regulation of trade in cultural products in ways that would be otherwise inconsistent with the FTA.

After Canada and the United States entered into the FTA, Canada, Mexico, and the United States agreed to the North American Free Trade Agreement ("NAFTA") on December 17, 1992.<sup>44</sup> As a result, the FTA was merged into NAFTA and effectively "suspended" during NAFTA's existence.<sup>45</sup> NAFTA preserved many of the FTA's provisions, including the cultural exemption.<sup>46</sup> Canada and the United States are still permitted to enact measures related to cultural products that are otherwise inconsistent with NAFTA.

Canada and the United States are both members of the WTO. Unlike the FTA and NAFTA, GATT contains no cultural exemption.<sup>47</sup> In fact, the only provision that specifically applies to trade in cultural products is Article IV, which exempts quotas imposed on cinematographic films from Article III's national treatment requirements.<sup>48</sup> As a result, any trade law involving cultural products, other than cinematographic films, must be consistent with the provisions of GATT.

#### D. CANADIAN PROTECTIONIST MEASURES

Since the early 1900s, Canada had provided favorable postal rates to support its periodical industry.<sup>49</sup> The postal rates were administered through the Canada Post Corporation ("Canada Post"), the Canadian Government's national postal ser-

43. *Id.* art. 2012(a).

44. North America Free Trade Agreement, Dec. 17, 1992, U.S.-Mex.-Can., 32 I.L.M. 289 and 32 I.L.M. 605 [hereinafter NAFTA].

45. JOHN H. JACKSON ET AL., LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS 489 (3d. ed. 1995).

46. NAFTA, annex 2106. Annex 2106 provides:

Notwithstanding any other provision of this Agreement, as between Canada and the United States, any measure adopted or maintained with respect to cultural industries, except as specifically provided in Article 302 (Market Access-Tariff Elimination), and any measure of equivalent commercial effect taken in response, shall be governed under this Agreement exclusively in accordance with the provisions of the Canada-United States Free Trade Agreement. The rights and obligations between Canada and any other Party with respect to such measures shall be identical to those applying between Canada and the United States.

*Id.*

47. *See generally* GATT.

48. *Id.* art. IV.

49. Task Force Report, *supra* note 19, at 72.



vice.<sup>50</sup> The Canadian Department of Communications (now the Department of Canadian Heritage) made annual payments to Canada Post.<sup>51</sup> These payments allowed Canada Post to provide lower postal rates to Canadian periodicals than it provided to non-Canadian periodicals.

In addition to supplying funding to Canada Post, the Department of Canadian Heritage regulated the eligibility requirements for the favorable postal rates.<sup>52</sup> Three postal rate categories were provided for periodicals.<sup>53</sup> These included the funded postal rate, the commercial postal rate, and the international postal rate.<sup>54</sup> Only Canadian periodicals were eligible for the funded and commercial postal rates.<sup>55</sup>

Because the Department of Canadian Heritage subsidized the funded rate, it was significantly lower than the other two postal rates.<sup>56</sup> To qualify for the funded rate, a periodical was required to be published and printed in Canada and had to be: (a) typeset and edited in Canada; (b) produced and published by a Canadian citizen, or a corporation controlled by Canadian citi-

50. First Submission of the U.S., *supra* note 35, ¶ 44.

51. *Id.* See also Memorandum of Agreement Concerning the Publications Assistance Program Between the Department of Communications and the Canada Post Corporation, Mar. 7, 1996, ¶ 3.0. The Department of Canadian Heritage was scheduled to provide funding in the following amounts to Canada Post:

- 1) \$58 million for the May 1, 1996 to March 31, 1997 time period;
- 2) \$57.9 million for the April 1, 1997 to March 31, 1998 time period;
- and
- 3) \$47.3 million for the April 1, 1998 to March 31, 1999 time period.

*Id.*

52. First submission of the U.S., *supra* note 35, ¶ 45.

53. *Id.* ¶ 38.

54. *Id.*

55. *Id.*

56. See *id.* ¶ 44 (explaining how the Department of Canadian Heritage defrays Canada Post's costs for the funded rate). The different postal rates for the three categories of periodicals are as follows:

International (i.e. imported):	\$0.436
Commercial:	\$0.378
Funded:	\$0.076 (first 10,000 copies of an issue and \$0.084 for additional copies)

(Rates based upon minimum postage per addressed copy.)

*Id.* ¶ 41.

Canada Post also furnished additional discounts, known as "palletization" and "bypass" discounts, exclusively to Canadian periodicals. *Id.* ¶ 42. Both discounts allowed the Canadian publishers to save money by performing various bulk packaging functions themselves rather than paying higher postal rates to have Canada Post perform them. *Id.* The palletization discount was \$0.01 to \$0.02 per copy or \$0.10 to \$0.30 per package of copies. *Id.* The by-pass discounts ranged from \$150 to \$200 per truckload. *Id.*

zens; and (c) not published under license from a foreign publisher, or contain editorial content substantially the same as an issue printed outside Canada that was not first edited in Canada.<sup>57</sup> The Department of Canadian Heritage provided Canada Post with the names of periodicals that qualified for the funded rates.<sup>58</sup>

The commercial rate was not subsidized and was, therefore, higher than the funded rate.<sup>59</sup> The international rate, which applied to all imported periodicals mailed in Canada, was significantly higher than the funded postal rate. In fact, the international postal rate was eighty-three percent higher than the funded postal rate and fourteen percent higher than the commercial postal rate.<sup>60</sup> Thus, international publishers were forced to pay higher postal rates than Canadian publishers to transport their periodicals to their Canadian customers.

Since 1976, Canada has also used an income tax measure to encourage Canadian advertisers to place their advertisements in Canadian periodicals. Section 19 of the Income Tax Act denies deductions for advertising costs incurred by Canadian advertisers for advertisements placed in non-Canadian periodicals, newspapers, and broadcasts that are directed primarily at the Canadian market.<sup>61</sup> Only advertisements placed by Canadian advertisers in Canadian periodicals are tax deductible.<sup>62</sup> To qualify as a Canadian periodical under Section 19, a periodical must be at least seventy-five percent Canadian-owned, and its editorial content must be at least eighty percent different than the content of an issue of the periodical that was printed, edited, or published outside Canada.<sup>63</sup>

Because of their ability to offer substantially lower advertising rates, split-run periodicals are disfavored by the Canadian government.<sup>64</sup> As a result, Canada passed certain measures to

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57. *Id.* ¶ 40.

58. *Id.* ¶ 45.

59. *Id.* ¶ 38.

60. The "international" rate is \$0.436, as compared to the \$0.076 rate for the "funded" rate and \$0.378 for the "commercial" rate. *Id.* ¶ 40. Thus, the "international rate" is 83% higher than the "funded" rate, and 14% higher than the "commercial" rate.

61. Income Tax Act, *supra* note 31, § 19(1).

62. *Id.* § 19(5).

63. *Id.*

64. See Task Force Report, *supra* note 19, at v (stating that the government's long-standing policy objective for Canadian magazines is to ensure access to advertising revenues and that split-runs would cause a downward spiral).

prevent split-run periodicals from entering the Canadian market.<sup>65</sup> In 1965, Canada enacted Tariff Code 9958 ("Import Ban").<sup>66</sup> The Import Ban forbade the actual importation of the hard copy of a split-run periodical into Canada. It was designed to operate as a barrier to prevent the importation of split-run periodicals, primarily from the United States, into Canada.<sup>67</sup>

On the surface, these Canadian measures and the cultural exemption do not appear to impose substantial barriers to the entry and sale of American periodicals in Canada. Currently, eighty-two percent of all newsstand periodicals sold in Canada originate from foreign countries, mainly the United States.<sup>68</sup> Seventy-eight percent of all American periodical exports go to Canada.<sup>69</sup> In addition, Canada annually imports twenty-five times more periodicals from the United States than it exports to the United States.<sup>70</sup>

Other U.S. cultural producers are also doing very well in Canada. Slightly under two-thirds of all books purchased in Canada are foreign-authored.<sup>71</sup> Sixty-three percent of Canadian television viewing time is spent watching non-Canadian programs, primarily programs originating from the United States.<sup>72</sup> The United States enjoys a \$1.5 billion trade surplus in cultural products with Canada.<sup>73</sup> Thus, the Canadian market is a very important export market for U.S. producers of cultural products.

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65. See *id.* at iii. Since 1965 two legislative measures were put into place that supported the Canadian magazine industry's flow of advertising. *Id.* These measures were primarily put into place to prevent split-run periodicals from entering the Canadian market. David Crary, *Is Canada Putting up a Cultural Wall?*, MINNEAPOLIS STAR TRIB., Jan. 1, 1996, at 8D.

66. Customs Tariff, R.S.C., ch. 41, § 114, sched. VII, item 9958 (1985, 3rd Supp.) (Can.) [hereinafter Import Ban].

67. First Submission of the U.S., *supra* note 35, ¶¶ 7-12.

68. Donald Macdonald, *The Canadian Cultural Industries Exemption Under Canada-U.S. Trade Law*, 20 CAN.-U.S. L.J. 253, 254 (1994).

69. Task Force Report, *supra* note 19, at 40.

70. *Id.*

71. *Id.*

72. *Id.*

73. Macdonald, *supra* note 65, at 254 (citing David Crane, *Canadian Culture Seen as a Pawn in Free Trade Talks*, TORONTO STAR, Aug. 4, 1986, at A-2). The United States has, however, typically maintained an overall trade deficit with Canada. In 1996, for example, the United States had an overall trade deficit of \$21.7 billion with Canada. James, *supra* note 38.

### E. THE EVENTS LEADING TO THE *SPORTS ILLUSTRATED CANADA* CONTROVERSY

The perpetual debate between Canada and the United States concerning cultural products recently returned to the forefront when Time Warner decided to publish and distribute a split-run edition of *Sports Illustrated* in Canada. The first copies of *Sports Illustrated Canada* hit Canadian newsstands on April 5, 1993,<sup>74</sup> and it quickly became a popular sports periodical there.<sup>75</sup> Canadian advertisers wanted to advertise in *Sports Illustrated Canada* because it offered substantially lower advertising rates than similar domestic periodicals and also possessed a substantial readership base in Canada.<sup>76</sup> *Sports Illustrated Canada's* instant success produced an uproar within the Canadian periodical community, which feared this type of publication would usurp the profits the industry derived from Canadian advertisers and cause irreparable damage to the industry.<sup>77</sup>

Since 1965, the Import Ban had effectively prevented the importation of split-run periodicals like *Sports Illustrated Canada* into Canada. Time Warner, though, bypassed the Import Ban by utilizing technological equipment that did not exist when Canada enacted the Ban. Time Warner produced the pages of

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74. *U.S. Weighing Retaliation Options on Canadian Magazine Tax*, INSIDE U.S. TRADE, Dec. 22, 1995, at 5.

75. See Lorne Manly, *Canada Could Get Pricey for Split-Run Editions*, FOLIO, Nov. 15, 1995, at 38 (estimating that *Sports Illustrated Canada* earned about \$1.8 million a year in advertising).

76. See *U.S. Weighing Retaliation Options on Canadian Magazine Tax*, supra note 74, at 5. In 1993, a full-page ad in *Sports Illustrated Canada* cost \$6250, compared with \$25,400 in *Macleans's*, one of the leading periodicals in Canada. *Id.* Because *Sports Illustrated* had already established its editorial content through the production of its American edition, which covered its fixed costs, the only costs it incurred in publishing its Canadian edition were variable costs, such as printing costs. *Id.*

77. See Peter C. Newman, *The Canadian Dream Loses a Big Round*, MACLEAN'S, Jan. 27, 1997, at 56 (claiming that "[w]hat's at stake is nothing less than the [Canadian] magazine's industry's continued existence"). Some forty U.S. periodicals with Canadian circulations of 50,000 or more were ready to launch their own split-run editions soon after *Sports Illustrated Canada* began publication. *Id.* See also Dian Turbide with Anthony Wilson-Smith, *Minister in the Hot Seat: Michael Dupuy is Responsible for Culture at a Volatile Time*, MACLEAN'S, May 9, 1994, at 54 (discussing the difficulties facing Canadian Heritage Minister Dupuy and how publishers are "distressed"); Patricia Chisholm, *Plugging a Loophole: Ottawa Moves to Protect Canadian Magazines*, MACLEAN'S, Aug. 2, 1993, at 40 (explaining how the advent of *Sports Illustrated Canada* caused consternation among Canadian publishers); Richard Siklos, *Magazine Report Pleases No One: Problem of Ersatz Canadian Editions Back in Ottawa's Lap*, FIN. POST, Mar. 31, 1994, at 14 (discussing Canadian publishers' reactions to *Sports Illustrated Canada*).

its *Sports Illustrated Canada* editions at its headquarters in New York and then transmitted them via satellite to the Company's printing plant north of Toronto.<sup>78</sup> Using this technique, Time Warner was able to distribute the split-run edition in Canada without violating the Import Ban, because no hard copy ever physically crossed the U.S.-Canadian border. These actions, though, obviously served to frustrate the law's underlying purpose.

In addition to the Import Ban, Section 19 of the Income Tax Act<sup>79</sup> had previously also caused a significant number of Canadian advertisers to avoid advertising in foreign periodicals. However, the introduction of *Sports Illustrated Canada*, along with its significantly lower advertising rates, decreased Section 19's ability to influence Canadian advertisers. The lower advertising rates more than offset the lost income tax deductions. Thus, the income tax deductions were ineffective in preventing Canadian advertisers from placing their advertisements in *Sports Illustrated Canada*.

After Time Warner announced its plan to publish a split-run edition in Canada, the Canadian government formed a Task Force to examine the Canadian periodical industry. The Task Force's purpose was to recommend legislative measures that would ensure an adequate flow of advertising revenue to the Canadian periodicals.<sup>80</sup> After a thorough examination of the Canadian periodical industry, the Task Force recommended that an excise tax<sup>81</sup> be used to prevent the entry of imported split-run periodicals into Canada.<sup>82</sup>

On December 15, 1995, the Canadian government enacted the Excise Tax Act ("Excise Tax").<sup>83</sup> This new law applied an eighty percent excise tax on the value of the advertisements appearing in split-run periodicals.<sup>84</sup> The Excise Tax essentially

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78. Peter Benesh, *New Sports Illustrated Riles Canada*, PITTSBURGH POST-GAZETTE, Apr. 14, 1993, at C5.

79. See *supra* notes 61-63.

80. See Task Force Report, *supra* note 19, at iii.

81. An excise tax is a "tax imposed on the performance of an act, the engaging in an occupation, or the enjoyment of a privilege." BLACK'S LAW DICTIONARY 563 (6<sup>th</sup> ed. 1990).

82. Task Force Report, *supra* note 19, at 64.

83. See An Act to Amend the Excise Tax Act and the Income Tax Act, ch. 46, 1995 S.C. (Can.) [hereinafter Excise Tax Act].

84. *Id.* § 36(1). The eighty percent tax was assessed on the split-run periodicals based on the total gross fees collected by the publisher for all advertisements included in the Canadian edition. *Id.* § 38. The tax was payable by the end of the month following the month in which the Canadian edition of the

sought to preclude Time Warner, and the numerous U.S. periodical publishers who were considering publishing split-run editions, from distributing such editions in Canada.<sup>85</sup>

The Canadian government made the Excise Tax retroactively applicable to all split-run editions that began publication after March 1993, subject to a grandfather provision.<sup>86</sup> This grandfather provision provided an annual exemption from the Excise Tax for the number of split-run editions that a company had published in the twelve month period immediately preceding March 26, 1993.<sup>87</sup> For example, a split-run periodical that had published twelve issues between March 26, 1992 and March 25, 1993, could continue to publish twelve issues a year without paying the Excise Tax. If a thirteenth issue were published, the Excise Tax would be applied on the value of the advertisements appearing in that issue.

Canada included this provision to avoid the application of the Excise Tax to long-established foreign split-run periodicals, including *Time* and *Reader's Digest*, which each published a Canadian edition.<sup>88</sup> The Excise Tax did, however, apply to all the

periodical was published. *Id.* § 37. The "responsible person" resident in Canada was to pay the tax. *Id.* § 36(2). Section 35(1) defines a "split-run edition" as an edition of a periodical:

- (a) that is distributed in Canada,
- (b) in which more than 20% of the editorial material is the same or substantially the same as editorial material that appears in one or more excluded editions of one or more issues of one or more periodicals, and
- (c) that contains an advertisement that does not appear in identical form in all those excluded editions.

*Id.* § 35(1).

In addition, section 35(1) defines an "excluded edition" as "an edition of the issue the circulation of which in Canada, if any, is less than its circulation outside Canada . . ." *Id.*

85. See Newman, *supra* note 77 (explaining that the purpose of the tax was to prevent U.S. periodicals from launching split-run publications in Canada). See also *Canadian Commission Softens Call for Discrimination in AV Sector*, INSIDE U.S. TRADE, Oct. 13, 1995, at 12, 14 (reporting that Canadian officials have said that "the tax will be applied to all split-runs, regardless of country of origin."). The new law sought to prevent foreign split-run periodicals, such as *Sports Illustrated Canada*, from taking advertising revenues away from the Canadian magazine industry. See *id.* at 13 (reporting on Minister of Department of Canadian Heritage Michel Dupuy's statement that without the new law, the Canadian magazine industry could lose 40% of its advertising revenue in the next five years).

86. Excise Tax Act, *supra* note 83, § 39.

87. *Id.*

88. *Id.* *Time* and *Reader's Digest* were exempted in 1965 under the original Excise Tax Act. Cray, *supra* note 65, at 8D.

editions published by *Sports Illustrated Canada*, because it did not begin publication until April 1993.<sup>89</sup>

According to the Canadian government, the Excise Tax was necessary because the Canadian periodical industry was in danger of being overrun by the larger and wealthier American periodical industry.<sup>90</sup> The Task Force concluded that "split-run [periodicals] have the potential to grab 40 per cent of Canadian [periodical] advertising revenues."<sup>91</sup> According to the United States, the Excise Tax was a discriminatory trade measure enacted specifically to evict an American business from the Canadian market.<sup>92</sup> The United States asserted that "[t]he predictable effect of this confiscatory excise tax was to force Time Warner to discontinue the publication of *Sports Illustrated Canada* and also to ensure that no new foreign-based split-run editions are distributed in Canada."<sup>93</sup> In addition, according to the United States, Canada's retroactive application of the tax to periodicals that began publication after March 26, 1993 revealed its confiscatory character and protectionist nature, because the tax reached back more than two years prior to its enactment to eliminate *Sports Illustrated Canada*.<sup>94</sup>

The Excise Tax ultimately forced Time Warner to suspend publication of *Sports Illustrated Canada*.<sup>95</sup> The eighty percent Excise Tax rendered the publication of this split-run edition economically unfeasible.<sup>96</sup> The enactment of the Excise Tax constituted a complete change of policy by the Canadian government regarding the publication of *Sports Illustrated Canada*. Before Time Warner decided to publish its Canadian edition of *Sports Illustrated*, Investment Canada had advised Time Warner that

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89. Task Force Report, *supra* note 19, at 34.

90. See *Canadian Commission Softens Call for Discrimination in AV Sector*, *supra* note 85, at 13 (reporting the statement of Minister Dupuy that "the threat to the health of the [Canadian periodical industry] is real").

91. Canadian Heritage, News Release Communiqué: House of Commons Passes Bill C-103 (Nov. 3, 1995).

92. First Submission of the U.S., *supra* note 35, ¶ 34-35. *But see* Second Submission of Canada in Canada—Certain Measures Concerning Periodicals, 19XX WL 213178 (W.T.O.) (Nov. 1, 1996), ¶ 23 [hereinafter Second Submission of Canada] (claiming that the date chosen was not an arbitrary choice since it was the date on which the Task Force of the Canadian Magazine Industry was established).

93. First Submission of the U.S., *supra* note 35, ¶ 35.

94. *Id.* ¶ 55.

95. See *Sports Illustrated Suspends Publication Pending End to Tax Dispute*, INSIDE U.S. TRADE, Jan. 12, 1996, at 19.

96. *U.S. Initiates WTO Case Over Canadian Split-Run Policies, Postal Rates*, INSIDE U.S. TRADE, Mar. 15, 1996, at 6.

a Canadian edition would not be inconsistent with any Canadian law.<sup>97</sup> Relying on this representation, Time Warner commenced the publication of *Sports Illustrated Canada*.<sup>98</sup> The subsequent enactment of the Excise Tax reversed the Canadian government's policy regarding *Sports Illustrated Canada*. Time Warner strongly considered individually challenging the constitutionality of the Excise Tax under Canadian law.<sup>99</sup> Ultimately, though, the conflict was dealt with by the United States' initiation of dispute settlement proceedings against Canada in the World Trade Organization.<sup>100</sup>

## II. THE RESOLUTION OF THE *SPORTS ILLUSTRATED* CONTROVERSY

### A. THE UNITED STATES INVOKES DISPUTE SETTLEMENT PROCEDURES IN THE WTO

In the *Sports Illustrated Canada* controversy, the main concern for the United States Trade Representative ("USTR") was securing access for U.S. split-run periodicals to the Canadian market. The USTR explored its options for retaliating against the Excise Tax. It ultimately chose to initiate dispute settlement in the WTO in the context of a Section 301 investigation.<sup>101</sup>

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97. See First Submission of the U.S., *supra* note 35, ¶ 16.

98. *Id.*

99. *SI Canada Poised to Challenge Constitutionality of Advertising Tax*, INSIDE U.S. TRADE, Aug. 25, 1995, at 4. *Sports Illustrated Canada* considered challenging the tax as violating three separate provisions of the Canadian constitution. *Id.* First, under Canadian law, taxes must raise revenue and be of general application. *Id.* Since no split-run editions would sell advertising at the proposed eighty percent level of taxation, the tax would raise no revenue and therefore would violate the Canadian law. *Id.* Second, over the last 100 years, the Canadian judiciary has articulated an "improper purpose doctrine" that, among other things, bars tax provisions that single out one company or individual, which *Sports Illustrated Canada* claimed this tax attempted to accomplish. *Id.* Finally, *Sports Illustrated Canada* considered challenging the tax as violating the freedom accorded commercial speech, including the stipulation advertisers should have access to the medium of their choice. *Id.*

100. See *U.S. Initiates WTO Case Over Canadian Split-Run Policies, Postal Rates*, *supra* note 96, at 6.

101. *Id.* at 7. Section 301 provides for mandatory action by the United States Trade Representative (USTR) if "an act, policy, or practice of a foreign country . . . is unjustifiable and burdens or restricts United States commerce." 19 U.S.C. § 2411(a)(1)(B)(ii). Furthermore, it provides for discretionary action if "an act, policy, or practice of a foreign country is unreasonable or discriminatory and burdens or restricts United States commerce, and . . . action by the United States is appropriate." 19 U.S.C. § 2411(b)(1), (2). In taking action, the USTR is authorized to initiate many different courses of action, including "sus-



On March 11, 1996, the United States initiated dispute settlement proceedings in the WTO and requested consultations<sup>102</sup> with Canada pursuant to Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU")<sup>103</sup> and GATT Article XXIII.<sup>104</sup> The United States and Canada held consultations on April 10, 1996 but were unsuccessful in resolving the dispute.<sup>105</sup> On May 24, 1996, the United States requested the establishment of a panel.<sup>106</sup> On June 19,

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pend[ing the] . . . benefits of trade agreement concessions . . ." or "impos[ing] duties . . . on the goods of . . . such foreign country." 19 U.S.C. § 2411(c)(1)(a), (b). Section 301 requires a determination by the USTR no later than 30 days after the conclusion of the WTO dispute settlement process or 18 months after the start of the 301 case, whichever is earlier. *Id.* See also Trade Act of 1974, § 301, 19 U.S.C. §§ 2411-20 (1994).

102. Consultations are the initial step to dispute resolution in the WTO. The disputing parties are required to consult with one another with a view toward satisfactorily resolving the dispute. JACKSON, *supra* note 45, at 341. The hope is that the parties will resolve their dispute without resorting to the formal dispute settlement procedures. *Id.* If consultations fail to resolve the dispute within 60 days after the request for consultations, the complaining party may request the establishment of a panel. Understanding on Rules and Procedures Governing the Settlement of Disputes, April 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, LEGAL INSTRUMENTS-RESULTS OF THE URUGUAY ROUND vol. 31; 33 I.L.M. 112 (1994) [hereinafter DSU].

103. DSU, art. 4. Under Article 4, consultation between the countries involved in the dispute is the initial step. *Id.* art. 4.3. If the parties fail to settle the dispute within 60 days or the parties agree during the 60 day period that consultations will not resolve the dispute, then the complaining party may request the establishment of a panel. *Id.* art. 4.7.

104. GATT, art. XXIII:1. Article XXIII:1 provides:

If any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the Agreement is being impeded as a result of

- (a) the failure of another contracting party to carry out its obligations under this Agreement, or
- (b) the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement, or
- (c) the existence of any other situation,

the contracting party may, with a view to the satisfactory adjustment of the matter, make written representations or proposals to the other contracting party or parties which it considers to be concerned. Any contracting party thus approached shall give sympathetic consideration to the representations or proposals made to it.

*Id.*

105. First Submission of the U.S., *supra* note 35, ¶ 3.

106. *Id.* ¶ 4.

1996, the Dispute Settlement Body ("DSB") assembled a panel to hear the dispute.<sup>107</sup>

B. THE DECISION OF THE CANADA—CERTAIN MEASURES CONCERNING PERIODICALS PANEL

Before the Panel hearing, the United States attacked Canada's favorable postal rates, Import Ban, and Excise Tax. The United States claimed that the favorable postal rates were an impermissible internal regulation, violating the requirements of Article III:4, and were an impermissible subsidy under Article III:8(b).<sup>108</sup> In addition, the United States asserted that the Import Ban constituted an impermissible import restriction under Article XI.<sup>109</sup> Finally, the United States argued that the Excise Tax was an impermissible internal tax under Article III:2.<sup>110</sup>

Canada responded to the U.S. claims by asserting that its measures were consistent with its GATT obligations. It claimed the favorable postal rates were not an impermissible internal regulation under Article III:4.<sup>111</sup> In the alternative, if the Panel concluded that the postal rates were inconsistent with Article III:4, Canada claimed the rates satisfied the requirements of Article III:8(b) and were, therefore, a permissible subsidy.<sup>112</sup> Canada admitted that the Import Ban was inconsistent with Article XI, but claimed that the Import Ban was still permissible because it satisfied the requirements of the Article XX(d) general exception.<sup>113</sup> Finally, Canada asserted that the Excise Tax was a measure applied strictly to advertising services and, consequently, only GATS governed any resolution of this issue.<sup>114</sup> In the alternative, if the panel concluded that GATT also was applicable to the Excise Tax, Canada claimed that the Excise Tax was consistent with the national treatment requirements of Article III:2.<sup>115</sup>

107. *Id.*

108. Report of the Panel in Canada—Certain Measures Concerning Periodicals, WT/DS 31/R, ¶ 3.1 (adopted March 14, 1997) [hereinafter Canada—Certain Measures panel].

109. *Id.*

110. *Id.*

111. *Id.* ¶ 3.2.

112. *Id.*

113. *Id.*; see *infra* notes 145–156 and accompanying text.

114. Canada—Certain Measures panel, *supra* note 108, ¶ 3.2.

115. *Id.*

## 1. Favorable Postal Rates

### a. Article III:4

The United States claimed that the higher international postal rates imposed by Canada on imported periodicals, compared to the funded and commercial postal rates paid by the Canadian periodicals, violated Article III:4 of GATT.<sup>116</sup> Article III:4 requires that imported products be “accorded treatment no less favourable” than that accorded to “like domestic products”<sup>117</sup> in regards to all regulations “affecting their internal sale, offering for sale, purchase, transportation, distribution or use.”<sup>118</sup>

With respect to this issue, Canada and the United States agreed that domestic and imported periodicals constituted like products and that Canada Post assessed higher postal rates on imported periodicals than on domestic periodicals.<sup>119</sup> Consequently, the key issue was whether Canada Post was “implementing Canadian government policy in such a manner that its postal rates on periodicals . . . [could] be viewed as governmental regulations or requirements for the purposes of Article III:4.”<sup>120</sup> According to the United States, Canada Post constituted a “government entity fully subject to Canadian Government direction because it [was] a wholly-government-owned, government-created chartered body, managed by a board of directors appointed by the Canadian Government.”<sup>121</sup> The United States asserted that statements by Diane Marleau, the Minister responsible for Canada Post, further demonstrated that even Canada consid-

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116. First Submission of the U.S., *supra* note 35, ¶ 80. See *supra* notes 49-57 and accompanying text (discussing the three different categories for periodicals and the applicable postal rates for each category).

117. See *infra* note 169-71 and accompanying text (discussing the “like products” test).

118. First Submission of the U.S., *supra* note 35, ¶ 79-89. See also GATT, *supra* note 8, art. III:4. Article III:4 states:

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. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

*Id.*

119. Canada—Certain Measures panel, *supra* note 108, ¶ 5.33.

120. *Id.* ¶ 5.34.

121. *Id.*

ered Canada Post to be a governmental entity.<sup>122</sup> Ms. Marleau had previously stated that “the [Canadian] government regards Canada Post as a significant federal institution,” and that the “Canada Post is part of the federal government.”<sup>123</sup>

Canada, on the other hand, characterized Canada Post as a private agency with a legal personality distinct from the Canadian government.<sup>124</sup> According to Canada, Canada Post possessed the ability to make its own decisions, which were typically based on normal commercial principles.<sup>125</sup> Because of this, the Canadian government asserted that it exercised no control over the postal rates Canada Post charged for the delivery of periodicals.<sup>126</sup>

According to the *Canada—Certain Measures Concerning Periodicals* panel (“Panel”), to consider a measure enforced by a private-sector entity a governmental regulation under Article III:4, two criteria needed to be satisfied. “First, there . . . [must be] reasonable grounds to believe that sufficient incentives or disincentives existed for non-mandatory measures to take effect. Second, the operation of the measures . . . [must depend] on Government action or intervention.”<sup>127</sup>

Applying these criteria to the Canadian postal rates, the Panel determined that the postal rates qualified as “regulations.”<sup>128</sup> First, the Panel stated that, based on the control exercised by the Canadian government, it could reasonably assume that sufficient incentives existed for Canada Post to maintain the existing pricing policy on periodicals.<sup>129</sup> Thus, the Panel simply assumed that the first criterion was satisfied.

Second, the Panel concluded Canada Post’s operation generally depended on action or intervention by the Canadian government.<sup>130</sup> Canada Post had a mandate from the Canadian government to operate on a “commercial” basis in the periodical sector.<sup>131</sup> In addition, the Canadian government possessed the

122. Second Submission of the United States of America in *Canada—Certain Measures Concerning Periodicals*, 1996 WL 899185 (W.T.O.) (Nov. 1, 1996), ¶ 91-92 [hereinafter Second U.S. Submission].

123. *Id.* ¶ 92 (emphasis in original).

124. *Canada—Certain Measures* panel, *supra* note 108, ¶ 5.33.

125. First Submission of Canada, *supra* note 12, ¶ 44.

126. *Canada—Certain Measures* panel, *supra* note 108, ¶ 5.33.

127. *Id.* ¶ 5.36 (citing *Japan—Trade in Semi-Conductors*, May 4, 1988, GATT B.I.S.D. (35th Supp.) at 116, ¶ 109 (1988)).

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.* ¶ 5.35.

power to change the postal rates if it considered Canada Post's pricing policy to be inappropriate.<sup>132</sup> Based on these facts, the Panel believed that Canada Post generally operated under governmental instructions.<sup>133</sup> Thus, the Panel concluded that the postal rates could be regulations and requirements under Article III:4.<sup>134</sup>

This conclusion did not completely resolve the issue. Because Article III:1 is a general principle that informs the rest of Article III,<sup>135</sup> the Panel needed to examine the postal rates under Article III:1 before reaching a final determination on this issue. Article III:1 provides that any internal taxes and laws of the importing country should not be "applied to imported or domestic products so as to afford protection to domestic production."<sup>136</sup>

The Panel concluded that the postal rates were inconsistent with Article III:1. According to the Panel, "the design, architecture, and structure of Canada Post's different pricing policy" led to the conclusion that Canada applied the measure "so as to afford protection to the domestic production of periodicals."<sup>137</sup> Thus, according to the Panel, the discriminatory application of the postal rates to periodicals violated Article III:4.<sup>138</sup>

b. Article III:8(b)

The Panel concluded that the funded postal rate offered by Canada Post to certain Canadian publishers qualified as a permissible subsidy under Article III:8(b).<sup>139</sup> Article III:8(b) provides an exception to Article III's national treatment requirements for subsidies paid "exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with

132. *Id.*

133. *Id.*

134. *Id.* ¶ 5.36.

135. *Id.* ¶ 5.37.

136. See GATT, art. III:1. Article III:1 provides:

The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

*Id.*

137. Canada—Certain Measures panel, *supra* note 108, ¶ 5.38.

138. *Id.* ¶ 5.39.

139. *Id.* ¶ 5.44.

the provisions of this Article and subsidies effected through governmental purchases of domestic products.”<sup>140</sup> Prior panels had construed Article III:8(b) very narrowly, and the United States believed that the Panel should follow this precedent.<sup>141</sup> The United States asserted that because the Department of Canadian Heritage paid the money to Canada Post rather than the Canadian periodical publishers, the payments were not made exclusively to domestic periodical publishers.<sup>142</sup> Nevertheless, the Panel postulated that the transfer of funds from the Department of Canadian Heritage to Canada Post merely involved an internal transfer of resources within the Canadian government.<sup>143</sup> The Panel stated that because Canada Post retained no economic benefit from the transfer of funds, the funded postal rate constituted a subsidy paid exclusively to Canadian periodical publishers and was therefore a permissible subsidy under Article III:8(b).<sup>144</sup>

## 2. *Import Ban*

Canada conceded that the Import Ban violated Article XI:1<sup>145</sup> but claimed that the Import Ban was justified under Ar-

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140. GATT, art. III:8(b). Canada argued that the payments to Canada Post constituted subsidies paid exclusively to domestic producers, as provided in Article III:8(b). First Submission of Canada, *supra* note 12, ¶ 114-115. It claimed that “[t]he specific form in which the subsidy is paid is irrelevant to the operation of Article III:8(b), provided that a payment is made by the government for the exclusive benefit of domestic producers.” *Id.* ¶ 117. Canada also asserted that the current system accomplished the same thing as a payment directly to the Canadian magazine producers, but under a much more administratively convenient format. *Id.* ¶ 118.

141. Second U.S. Submission, *supra* note 122, ¶ 104-10 (construing Report of the Panel on Italian Discrimination Against Agricultural Machinery, Oct. 23, 1958, GATT B.I.S.D. (7th Supp.) at 60, ¶ 14 (1959)); Report of the Panel on United States—Measures Affecting Alcoholic and Malt Beverages, June 19, 1992, GATT B.I.S.D. (39th Supp.) at 206, ¶ 5.8 (1992); Report of the Panel on United States—Measures Affecting the Importation, Internal Sale and use of Tobacco, Aug. 12, 1994, DS44/R (Oct. 4, 1994), ¶ 109; Report of the Panel on European Economic Community—Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins, Jan. 25, 1990, GATT B.I.S.D. (37th Supp.) at 86, ¶ 137 (1990)).

142. First Submission of the U.S., *supra* note 35, ¶ 90.

143. Canada—Certain Measures panel, *supra* note 108, ¶ 5.42.

144. *Id.* ¶ 5.44.

145. *Id.* ¶ 5.5. See also GATT, *supra* note 8, art. XI:1. Article XI:1 provides that:

No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licenses or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of

ticle XX(d), which permits certain GATT-inconsistent measures as long as they are necessary to secure compliance with a GATT-consistent measure.<sup>146</sup> To satisfy the Article XX(d) exception, Canada had to demonstrate the following elements:

1. that the particular trade measures, inconsistent with the General Agreement for which the exception was being invoked, secured compliance with laws or regulations themselves not inconsistent with the General Agreement;
2. that the inconsistent measures were necessary to secure compliance with those laws or regulations; and
3. that the measures were applied in conformity with the introductory clause of Article XX.<sup>147</sup>

Important precedent on how to interpret Article XX(d) was set by the Panel on *European Economic—Regulations on Imports of Parts and Components*, which determined that the phrase “to secure compliance with laws and regulations” in Article XX(d) meant “to enforce obligations under laws and obligations,” and not merely “to ensure the attainment of the objectives of the laws and regulations.”<sup>148</sup>

Canada asserted that the Import Ban was necessary to secure compliance with Section 19 of the Income Tax Act.<sup>149</sup> Canada also claimed that the Article XX(d) standard should not be strictly applied to the present dispute.<sup>150</sup> According to Canada, a strictly applied test “is entirely appropriate where the issue is

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any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party.

*Id.*

146. GATT, art. XX(d). Article XX states:

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

....

(d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement . . . .

*Id.*

147. Canada—Certain Measures panel, *supra* note 108, ¶ 5.7 (citing Panel Report on United States—Standards for Reformulated and Conventional Gasoline, WTO Doc. WT/DS2/R (Jan. 29, 1996), *reprinted in* 35 I.L.M. 274 (1996)).

148. *See id.* ¶ 5.9 (quoting Panel Report on European Economic Community—Regulations on Imports of Parts and Components, May 16, 1990, GATT B.I.S.D. (37th Supp.) at 132 (1990)).

149. First Submission of Canada, *supra* note 12, ¶ 102; *see also* Income Tax Act, *supra* notes 60-62 and accompanying text.

150. First Submission of Canada, *supra* note 12, ¶ 102.

the enforcement of regulatory statutes and ordinary fiscal measures designed to raise revenue, where compliance with the statute is virtually synonymous with the attainment of its objects."<sup>151</sup> On the other hand, Canada asserted that "[i]t is doubtful . . . that [a strictly applied test] is meaningful in the case of a fiscal or other economic incentive where formal compliance is not the real object, and *substantial* compliance cannot be separated from the underlying social and economic objectives the measure is designed to secure."<sup>152</sup> Thus, according to Canada, applying the standard more leniently, the Import Ban did not arbitrarily or unjustifiably discriminate between domestic and imported periodicals, and thus was justified under Article XX(d).<sup>153</sup>

The Panel disagreed with Canada's assertion. It stated that although the Import Ban may increase "compliance" with Section 19 of the Income Tax Act, this was only an incidental effect caused by a separate measure, distinct from Section 19 and its objective to entice the placement of advertisements in Canadian periodicals as opposed to foreign periodicals.<sup>154</sup> The Panel concluded that the Import Ban did not "secure compliance" with Section 19 of the Income Tax Act.<sup>155</sup> Because this element was not satisfied, the Panel held that the Import Ban was inconsistent with Article XI:1 and not justified under Article XX(d).<sup>156</sup>

### 3. Excise Tax

Canada characterized the Excise Tax as a tax applied to advertising services and therefore asserted that the Excise Tax issue was governed by GATS,<sup>157</sup> which applies to trade in

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151. *Id.* ¶ 101.

152. *Id.*

153. *Id.* ¶ 103.

154. Canada—Certain Measures panel, *supra* note 108, ¶ 5.10.

155. *Id.* Because the Import Ban failed the "secure protection" element, the Panel did not determine whether the "necessary to secure compliance" element or the introductory clause elements had been satisfied. *Id.* ¶ 5.11.

156. *Id.* ¶ 5.11.

157. Under GATS, the word "services" encompasses more than one hundred different service sectors, including banking, tourism, and law. JACKSON, *supra* note 45, at 291. Like GATT, GATS has an MFN provision and a national treatment provision. *Id.* GATS, however, also contains rules of competition, a monopoly policy, and rules on government procurement. *Id.* See also Second Submission of Canada, *supra* note 92, ¶ 9. According to Canada,

[because] GATS is a more specific expression of the intention of WTO Members with respect to disciplines applicable to trade in services, it should prevail over the GATT 1994 in case of a true conflict, where the conflict relates primarily to trade in services. The more appropriate



services, rather than GATT, which governs trade in goods.<sup>158</sup> Canada claimed that revenue streams should be split into two different classifications: circulation revenue, which is derived from the sale of a good, and advertising revenue, which is derived from the sale of a service.<sup>159</sup> Canada asserted that “[t]he significant point . . . is that the tax is measured not in terms of the price of the magazines but in terms of the advertising revenues it generates.”<sup>160</sup> Thus, according to Canada, because it had “not undertaken any commitments in respect of the provision of advertising services . . . there [we]re *no* restrictions on Canada in respect of the introduction of measures concerning the provision of advertising services.”<sup>161</sup>

The Panel disagreed with Canada, stating that “advertising services have long been associated with the disciplines under GATT Article III.”<sup>162</sup> According to the Panel, numerous prior panels examined services in the context of Article III.<sup>163</sup> Furthermore, this tax was applied to the periodicals on a “per issue” basis, which the Panel believed demonstrated that the Excise Tax was applied to a good.<sup>164</sup> The Panel concluded that because GATS and GATT were not mutually exclusive agreements, both agreements could apply to the Excise Tax segment of this controversy.<sup>165</sup>

After determining that the agreements were not mutually exclusive, the Panel proceeded to examine the Excise Tax under

approach is clearly to interpret both agreements so as to minimize any overlaps and resulting conflicts, and thus to preserve the integrity and independence of each regime as the negotiators intended.

*Id.* ¶ 7.

158. First Submission of Canada, *supra* note 12, ¶ 57. See also W. Ming Shao, *Is There No Business Like Show Business? Free Trade and Cultural Protectionism*, 20 YALE J. INT’L L. 105, 124 (1995) (stating that the classification of audiovisual services as either goods or services tends to obscure the treatment of them as a public good). “[T]hree characteristics commonly distinguish services from goods. First, production and consumption must be simultaneous in the case of services but not goods. Second, unlike goods, services are impossible to store. Third, services are intangible, while goods are tangible.” *Id.*

159. First Submission of Canada, *supra* note 12, ¶ 58.

160. Second Submission of Canada, *supra* note 92, ¶ 5.

161. First Submission of Canada, *supra* note 12, ¶ 63.

162. Canada—Certain Measures panel, *supra* note 108, ¶ 5.18.

163. *Id.* (citing Canada—Import Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies, Feb. 18, 1992, GATT B.I.S.D. (39th Supp.) at 27 (1992); United States—Measures Affecting Alcoholic and Malt Beverages, June 19, 1992, GATT B.I.S.D. (39th Supp.) at 206 (1993); Thailand—Restrictions on Importation of and Internal Taxes of Cigarettes, Feb. 20, 1990, GATT B.I.S.D. (37th Supp.) at 200 (1990)).

164. Canada—Certain Measures panel, *supra* note 108, ¶ 5.15.

165. *Id.* ¶ 5.19.

GATT Article III:2, first sentence.<sup>166</sup> In general, Article III, GATT's national treatment provision, attempts to ensure that the trading countries maintain competitive conditions.<sup>167</sup> "[T]he rationale for the national treatment obligation of Article III is to protect expectations of the Members as to the competitive relationship between their products and those of other Members."<sup>168</sup>

Under Article III:2, first sentence, imported products "shall not be subject . . . to internal taxes . . . in excess of those applied . . . to like domestic products."<sup>169</sup> To determine whether the Excise Tax violated Article III:2, first sentence, the Panel needed to determine the following: (1) whether imported split-run periodicals and domestic non-split-run periodicals constituted "like products" and (2) if they were like products, whether Canada subjected imported split-run periodicals to an internal tax in excess of that applied to domestic non-split-run periodicals.<sup>170</sup>

First, the Panel attempted to discern whether imported split-run periodicals and domestic non-split-run periodicals were "like products." According to the Panel, under Article III:2, first sentence, "like products" should be construed narrowly, on a case-by-case basis, and in light of such factors as [1] the product's end uses in a given market, [2] consumer's tastes and habits, and [3] the product's properties, nature and quality."<sup>171</sup>

Because the Import Ban effectively blocked the actual importation of any split-run periodicals into Canada, the Panel was forced to perform its comparison of imported split-run periodicals and domestic non-split-run periodicals on the basis of a hypothetical import. In an unprecedented analysis, the Panel used the Canadian and U.S. editions of the Canadian-owned periodical *Harrowsmith Country Life* instead of examining the periodical comparisons provided by the parties.<sup>172</sup> The Panel believed that the two editions of this periodical were representa-

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166. *Id.* ¶ 5.22-27

167. *Id.* ¶ 5.26.

168. *Id.* ¶ 5.23 (citing United States—Taxes on Petroleum and Certain Imported Substances, June 17, 1987, GATT B.I.S.D. (34th Supp.) at 136 (1988)).

169. GATT, art. III:2, first sentence.

170. Canada—Certain Measures Panel, *supra* note 108, ¶ 5.21. If the answer to both questions is in the affirmative, then Article III:2, first sentence, would be violated. *Id.* However, if the answer to the first question is in the negative, then an examination must be performed to determine whether Article III:2, second sentence, has been violated. *Id.*

171. *Id.* ¶ 5.22. (quoting Report of the Appellate Body in Japan—Taxes on Alcoholic Beverages Case, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R (Oct. 4, 1996)).

172. *Id.* ¶ 5.25.

tive of an imported split-run periodical and a domestic non-split-run periodical, even though they could never be in the Canadian market at the same time.<sup>173</sup>

Based on this hypothetical scenario, the Panel assumed that all of the volumes of *Harrowsmith Country Life* had been printed in the United States and were exempted from the coverage of the Import Ban.<sup>174</sup> If the Canadian edition were subsequently exported from the United States to Canada, *Harrowsmith Country Life* would be subject to the Excise Tax.<sup>175</sup> However, according to the Panel, if the publication of the U.S. edition were discontinued, the publisher would be no longer subject to the Excise Tax.<sup>176</sup> After performing this analysis, the Panel compared the two issues of *Harrowsmith Country Life* before and after the discontinuation of the U.S. edition.<sup>177</sup> The Panel concluded that the “like products” element was satisfied because the two editions of *Harrowsmith Country Life* had “common end-uses and very similar physical properties, natures, and qualities. It is most likely that the two volumes would have been designed for the same readership with the same tastes and habits.”<sup>178</sup>

Next, the Panel examined whether Canada subjected the imported split-run periodicals to an internal tax in excess of that assessed on the domestic non-split-run periodicals.<sup>179</sup> According to Canada, under Article III:2 “indirectly” was intended to refer to “taxes that apply to inputs that contribute to the production of a good, and not to the end products in their own right.”<sup>180</sup> Based on this rationale, Canada asserted that the Excise Tax did not “apply ‘indirectly’ to a good within the meaning of Article III:2.”<sup>181</sup>

The Panel concluded that “indirectly” was meant not only to refer exclusively to inputs. Instead, according to the Panel, the Excise Tax was applied “indirectly” because it was applied on the value of the advertisements in a periodical on a per-issue basis rather than on the periodical itself.<sup>182</sup> Thus, because the eighty percent Excise Tax only applied to the imported split-run

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173. *Id.*

174. *Id.*

175. *Id.*

176. *Id.*

177. *Id.*

178. *Id.*

179. *Id.* ¶ 5.27.

180. *Id.* ¶ 5.28.

181. *Id.*

182. *Id.* ¶ 5.29.

periodicals, the Panel concluded that the Excise Tax violated Article III:2, first sentence.<sup>183</sup>

At the end of its decision, the Panel stressed that “the ability of any Member to take measures to protect its cultural identity was not at issue” in this case.<sup>184</sup> Instead, the Panel stated that it examined the Canadian measures exclusively in relation to its GATT-consistency.<sup>185</sup> The Panel’s beliefs on whether this was a good or bad policy for the Canadian government to pursue did not influence the Panel’s decision.

### C. THE DECISION OF THE WTO APPELLATE BODY

Both Canada and the United States disagreed with certain conclusions reached by the Panel. Therefore, on April 29, 1997, an appeal was made to the WTO Appellate Body.<sup>186</sup> Canada disagreed with the Panel’s determinations that GATT applied to the Excise Tax and that the Excise Tax violated Article III:2.<sup>187</sup> The United States, on the other hand, claimed that the Panel erred in concluding that the favorable postal rates were a permissible subsidy under Article III:8(b).<sup>188</sup>

On appeal, the Appellate Body was limited to considering issues of law covered in the panel report and legal interpretations developed by the Panel.<sup>189</sup> As an initial matter, the Appellate Body agreed with the Panel’s conclusion that “obligations under GATT 1994 and GATS can co-exist and that one does not override the other.”<sup>190</sup> The Appellate Body concluded that the Excise Tax was a “measure which clearly applies to goods — it is an excise tax on split-run editions of periodicals.”<sup>191</sup> Consequently, the Appellate Body determined that the Excise Tax needed to comport with the national treatment requirements of Article III.<sup>192</sup>

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183. *Id.* ¶ 5.29-30.

184. *Id.* ¶ 5.45.

185. *Id.*

186. Report of the Appellate Body in Canada—Certain Measures Concerning Periodicals, AB-1997-2, WT/DS31/AB/R, (adopted 30 June 1997) [hereinafter Canada—Certain Measures Appellate Body].

187. *Id.* at 2.

188. *Id.* at 6.

189. DSU, art. 17.6.

190. Canada—Certain Measures Appellate Body, *supra* note 186, at 14. In other words, the existence of GATS does not diminish the application of GATT.

191. *Id.*

192. *Id.*

### 1. *Favorable Postal Rates*

The Appellate Body overturned the Panel's decision regarding the funded postal rates.<sup>193</sup> Initially, the Appellate Body stated that the phrase, "including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products" in Article III:8(b) demonstrated the types of permissible subsidies.<sup>194</sup> The Appellate Body also placed great emphasis on the fact that Canada never made a payment directly to the Canadian publishers.<sup>195</sup> According to the Appellate Body "an examination of the text, context, and object and purpose of Article III:8(b) suggests that it was intended to exempt from the obligations of Article III only the payment of subsidies which involves the expenditure of revenue by the government."<sup>196</sup>

The Appellate Body also examined the decision rendered by the *United States—Malt Beverages* panel,<sup>197</sup> which concluded that a reduction in the taxes placed on a good did not qualify as a subsidy payment.<sup>198</sup> Similarly, according to the Appellate Body, the reduction in postal rates should not qualify as a subsidy payment because Article III:8(b) was only intended to permit the payment of subsidies that involve the expenditure of revenue by a government.<sup>199</sup> Because the postal rates did not involve an actual expenditure of revenue by the Canadian government, the Panel concluded that the funded postal rate was not a permissible subsidy under Article III:8(b).<sup>200</sup>

### 2. *Excise Tax*

The Appellate Body also disagreed with the Panel's "like product" analysis in the Excise Tax context.<sup>201</sup> The Appellate Body held that the example utilized by the Panel was technically incorrect, because it involved a comparison of two imported split-run periodicals produced by the same publisher rather than the required comparison of an imported split-run periodical

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193. *Id.* at 24.

194. *Id.* at 23.

195. *Id.* at 22-24.

196. *Id.* at 24.

197. *United States—Measures Affecting Alcoholic and Malt Beverages*, June 19, 1992, GATT B.I.S.D. (39th Supp.) at 206 (1992).

198. *Canada—Certain Measures Appellate Body*, *supra* note 186, at 23.

199. *Id.* at 24.

200. *Id.*

201. *Id.* at 24.

and a domestic non-split-run periodical.<sup>202</sup> This absence of adequate analysis prevented the Appellate Body from reviewing the “like products” issue, because of its inability to retry facts.<sup>203</sup>

The Appellate Body did conclude, though, that it possessed the power to analyze the Excise Tax in light of Article III:2, second sentence.<sup>204</sup> Article III:2, second sentence, which involves a broader category of products than “like products,” prohibits countries from applying dissimilar taxes to directly competitive or substitutable imported products “so as to afford protection to domestic production.”<sup>205</sup> To show a violation of Article III:2, second sentence, the United States needed to prove the following three elements: (1) that the imported split-run periodicals and domestic non-split-run periodicals constituted directly competitive or substitutable products; (2) that the imported split-run periodicals and domestic non-split-run periodicals were not similarly taxed; and (3) that Canada applied this dissimilar taxation “so as to afford protection” to domestic non-split-run periodicals.<sup>206</sup>

In the “directly competitive or substitutable products” context, the Appellate Body stated that it was appropriate to examine “competition in the relevant markets as one among a

202. *Id.* at 15. In addition, the Appellate Body chastised the Panel for failing to use the exhibits and evidence introduced by the parties in rendering its decision. *Id.* In particular, Canada submitted copies of *Time*, *Time Canada*, and *Maclean's* periodicals, while the United States presented editions of *Pulp & Paper* and *Pulp & Paper Canada*. *Id.*

203. *Id.* at 16. According to Article 17.6 of the DSU, an appeal shall be limited to the issues of law covered in the panel report and legal interpretations developed by the panel. *Id.* Because the panel report was inadequate in this respect, the Appellate Body was unable to render a determination on the “like products” issue. *Id.*

204. *Id.* at 16-17.

205. See GATT, art. III:2, second sentence. Article III:2, second sentence, provides:

[N]o contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

*Id.*

See also *supra* note 136 for the text of Article III:1, with which Article III:2, second sentence, requires compliance. See also GATT, ad art. III. Ad Article III, Paragraph 2 states:

A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed.

*Id.*

206. Canada—Certain Measures Appellate Body, *supra* note 186, at 17.

number of means of identifying the broader category of products that might be described as 'directly competitive or substitutable.'<sup>207</sup> In addition, the Appellate Body agreed with the United States that the very existence of the Excise Tax provided substantial proof that imported split-run periodicals and domestic non-split-run periodicals constituted competitive products.<sup>208</sup> Moreover, the numerous quotations from Canadian sources further solidified the Appellate Body's determination that imported split-run periodicals and domestic non-split-run periodicals were "directly competitive or substitutable" products.<sup>209</sup>

The Appellate Body did, however, refrain from universally classifying all periodicals as directly competitive or substitutable. Instead, it stated that "[a] periodical containing mainly current news is not directly competitive or substitutable with a periodical dedicated to gardening, chess, sports, music or cuisine."<sup>210</sup> It did conclude that news periodicals, such as *Time*, *Time Canada*, and *Maclean's*, contained similar editorial content and were "directly competitive or substitutable in spite of the 'Canadian' content of *Maclean's*."<sup>211</sup> According to the Appellate Body, "[t]he competitive relationship is even closer in the case of more specialized magazines, like *Pulp & Paper* as compared to *Pulp & Paper Canada*."<sup>212</sup> The Appellate Body concluded that "imported split-run periodicals and domestic non-split-run periodicals are directly competitive or substitutable products so far as they are part of the same segment of the Canadian market for periodicals."<sup>213</sup>

The Appellate Body did agree with the Panel's conclusion that because Canada subjected only the split-run periodicals to the eighty percent Excise Tax, it did not similarly tax imported split-run periodicals and domestic non-split-run periodicals.<sup>214</sup> Furthermore, the Appellate Body determined that, based on the "magnitude of the differential taxation, the several statements of the Government of Canada's explicit policy objectives in intro-

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207. *Id.*

208. *Id.* at 18-19.

209. *Id.* at 19. For example, the Task Force Report stated "[Canadian publishers'] English-language consumer magazines face significant competition for sales from imported consumer magazines. In large measure, this is because the majority of the magazines are from the United States and are a close substitute. . . ." Task Force Report, *supra* note 19, at 40.

210. Canada—Certain Measures Appellate Body, *supra* note 186, at 20.

211. *Id.*

212. *Id.*

213. *Id.*

214. *Id.* at 20-21.

ducing the measure and the demonstrated actual protective effect of the measure . . . the design . . . of . . . the Excise Tax Act is clearly to afford protection to the production of Canadian periodicals."<sup>215</sup> Therefore, the Appellate Body concluded that the Excise Tax contravened Article III:2, second sentence.<sup>216</sup>

### III. ANALYSIS OF THE *SPORTS ILLUSTRATED CANADA* DISPUTE AND ITS IMPLICATIONS FOR THE RESOLUTION OF FUTURE DISPUTES

#### A. PANEL AND APPELLATE BODY DECISIONS

The *Sports Illustrated Canada* decisions will certainly influence the resolution of future trade disputes. The decisions of the Panel and the Appellate Body provide insight into how the WTO will construe certain GATT provisions under similar circumstances. For future panels, the favorable postal rates under Article III:8(b) and the overlapping spheres of GATS and GATT are the two most important resolutions rendered by the Panel and the Appellate Body.

##### 1. *Favorable Postal Rates*

The Appellate Body, in contrast to the Panel, concluded that the favorable postal rates were inconsistent with Article III:8(b).<sup>217</sup> In this dispute, support existed for either interpretation. On the one hand, the funded rate did fail to satisfy the textual requirements of Article III:8(b), because the Department of Canadian Heritage did not actually pay the subsidy exclusively to the Canadian periodical publishers. Instead, the funds were transferred to Canada Post, which provided the funded rate to the Canadian publishers.<sup>218</sup> On the other hand, the measure essentially accomplished the same result as a subsidy paid directly to the Canadian periodical publishers but in a more administratively convenient and cost-effective manner. By utilizing this process, the Canadian government saved an enormous amount of time and money, because the postal rates essentially were set at intervals that provided the same benefits to the Canadian periodical publishers as paying the subsidy directly to them.<sup>219</sup>

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215. *Id.* at 22.

216. *Id.*

217. *See supra* notes 193-200 and accompanying text.

218. *See supra* note 49-50 and accompanying text.

219. *See supra* notes 52-59 and accompanying text.



Unfortunately for Canada, the Appellate Body's conclusion will increase the cost of providing the subsidy without furnishing any substantial accompanying benefit. Essentially, the Appellate Body's conclusion will merely change the form of the subsidy and not its substance. The publishers will still receive the economic benefits of the subsidy, only now they will receive the benefits directly rather than indirectly.

Paying the subsidy directly to the Canadian periodical publishers increases administrative costs for many reasons. First, the Canadian government must determine the dollar amount of the subsidy to pay to each individual Canadian periodical publisher. Clearly, a periodical with few subscribers that publishes only a few issues a year is not entitled to the same subsidy amount as a periodical that publishes numerous issues each year and has a large number of subscribers. The postal rate subsidy allowed the Canadian government to avoid this problem, because the Canadian periodicals determined the amount of the subsidy they received based on the number of periodicals mailed.<sup>220</sup> In contrast, the Canadian government must now determine the subsidy amount to pay to each of the 1400 different Canadian periodicals.<sup>221</sup>

After the Canadian government determines the subsidy amount each publisher should receive, it will need to transfer this amount to them. Sending a subsidy payment to each of the publishers of the 1400 Canadian periodicals<sup>222</sup> would clearly be time-consuming and burdensome, especially compared to the prior process of simply transferring the necessary funds to Canada Post.<sup>223</sup> Thus, from a cost-effectiveness standpoint, the Appellate Body's conclusion results in a less desirable solution to this issue than the Panel's conclusion.

Based on the economic inadequacies of the Appellate Body's decision, it must have been based on policy considerations. Although not explicitly stated, the Appellate Body may have been concerned that permitting the Canadian postal rate subsidy essentially would have resulted in the insertion of an implied administrative convenience exception in Article III:8(b). The Appellate Body may have believed such an exception would result in numerous GATT violations being cloaked in the guise

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220. *Id.*

221. Task Force Report, *supra* note 19, at iv.

222. *Id.*

223. *See supra* note 49-50 and accompanying text.

of administrative convenience. The Appellate Body's decision assuredly prevents this type of problem.

It is unlikely, though, that numerous GATT violations would be accomplished through the use of an administrative convenience exception. For instance, in the current dispute, Canada Post apparently was using all of the funding it received from the Department of Canadian Heritage to provide the favorable postal rates to the Canadian periodicals. There was no evidence that it was withholding any of the funding. However, even if Canada Post had been withholding funding, the problem the Panel in *European Economic Community—Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins ("Oilseeds")*<sup>224</sup> attempted to prevent was not present in the current dispute. Unlike the *Oilseeds* context, Canada Post was a governmental entity, not a processor. Even if Canada Post had retained some of the funding it received, this funding would still have remained within the Canadian government. In contrast, the *Oilseeds* panel was concerned with preventing countries from providing too much funding to the processors in order to protect the domestic products.<sup>225</sup> Thus, the decision of the *Oilseeds* panel was inapposite to the resolution of the current dispute.

It is clear that the Panel, and not the Appellate Body, rendered the more viable solution to the postal rate subsidy issue. Allowing the postal rate subsidy makes sense from both a cost-effectiveness standpoint and a policy-based standpoint. Thus, Canada should have been permitted to continue its utilization of Canada Post as a conduit through which to provide the postal rate subsidy.

## 2. GATS v. GATT

Because the United States possessed a strong claim that the Excise Tax violated Article III's national treatment requirements, Canada's best defense was that GATS rather than GATT governed this area of the dispute. Both the Panel and the Appellate Body disagreed with this assertion. According to the Panel and the Appellate Body, GATS and GATT never were intended

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224. Report of the Panel on *European Economic Community—Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, Jan. 25, 1990, GATT B.I.S.D. (37th Supp.) at 86, ¶ 137 (1990)).

225. *Id.* ¶¶ 136-41.

to be mutually exclusive agreements.<sup>226</sup> They asserted that numerous panels had concluded that services could be examined under Article III of GATT.<sup>227</sup> The Panel and Appellate Body decided to faithfully adhere to these prior decisions.

The resolution of this issue was not as obvious as the Panel and Appellate Body made it appear. Faithful adherence to the prior panel decisions by future panels could result in erroneous resolution of trade disputes. For example, a future trade dispute could encompass trade involving periodicals provided to customers via the Internet. In a situation such as this, it is much more difficult to discern whether this is a transaction involving goods or a transaction involving services. In the *Sports Illustrated Canada* controversy, the Panel and Appellate Body adhered to the prior panel decisions and easily concluded that a periodical is a good. A future panel, though, could conclude that the periodical, like the advertising services in the current dispute, constitutes only a segment of the overall transaction. The Internet, like the periodical in the current dispute, would be the means of delivering the editorial and advertising content. However, unlike the periodical in the current dispute, Internet delivery would probably be classified as a service. Thus, in a situation such as this, faithful adherence to prior panel decisions could result in an erroneous resolution. Instead, a future panel will need to perform a more in-depth analysis of the spheres of GATS and GATT. The implication in the current dispute that this was a relatively straightforward decision for the Panel and Appellate Body is somewhat misleading. In actuality, numerous future panels will be forced to struggle with defining the spheres of these agreements.

## B. CANADA'S OPTIONS IN RESOLVING THE CONTROVERSY

### 1. *Canada's Options Before the United States Initiated Proceedings in the WTO*

Canada could have attempted to resolve the *Sports Illustrated Canada* controversy before the United States began dispute resolution proceedings in the WTO. One alternative would have been for Canada to include *Sports Illustrated Canada* in the grandfather provision,<sup>228</sup> thereby excluding it from the Excise Tax's coverage. This course of action could have prevented

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226. See *supra* notes 162-65, 190 and accompanying text.

227. See *supra* note 163 and accompanying text.

228. See *supra* notes 86-89.

the *Sports Illustrated Canada* controversy from ever occurring. Resolving the dispute in this manner certainly would not have looked as discriminatory, because an American business operating in Canada, especially one as powerful as Time Warner, would not have been removed from the Canadian market. Had Canada opted for this alternative, the United States might not have complained to the WTO. The Excise Tax would have been less important to the U.S. government because no American business would have suffered an immediate, verifiable injury. The fact that the Import Ban existed for over thirty years before the United States challenged it supports this inference.<sup>229</sup>

Even if this alternative would not have prevented the *Sports Illustrated Canada* controversy from occurring, it would have at least postponed the dispute until another American split-run periodical attempted to enter the Canadian market. Such a delay would have been very beneficial to Canadian periodical publishers. The publishers could have continued to operate their businesses without the threat of new imported split-run periodicals entering the Canadian market in the near future. The delay would also have given the Canadian government more time to analyze its current policy regarding periodicals. During this time, the Canadian government could have assessed its options and implemented a GATT-consistent vehicle through which to protect its periodical industry.

The overriding drawback to including *Sports Illustrated Canada* in the grandfather provision was its popularity in Canada and its ability to funnel advertising revenues away from the Canadian periodicals.<sup>230</sup> Given the instability of the Canadian periodical industry,<sup>231</sup> a substantial number of Canadian periodicals might have been unable to survive if *Sports Illustrated Canada* had been permitted to remain in the Canadian market. Faced with this possibility, the Canadian government found inclusion of *Sports Illustrated Canada* in the grandfather provision to be an unattractive alternative. Instead, to sustain the industry's viability, the Canadian government had to remove *Sports Illustrated Canada* from the Canadian market.

Another, perhaps more obvious, alternative for the Canadian government was to negotiate a settlement to this dispute with the United States. The countries could have made cross-sector concessions. For example, in exchange for the right to

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229. See *supra* notes 64-67.

230. See *supra* notes 64-67.

231. See *supra* notes 24-31.

maintain its GATT-inconsistent periodical measures, Canada could have agreed to provide trade concessions to the United States in a different industry. Depending on the trade concessions provided by Canada, this course of action could have resulted in a very desirable solution for both countries. It certainly would have been a very beneficial result for the Canadian periodical industry, because the status quo would have been maintained. The Canadian periodical publishers would not have been required to adapt to any new measures. Instead, the measures around which the Canadian periodical publishers had organized their operations would remain in place.

Negotiation, though, would have adversely affected the Canadian industry in which Canada granted the trade concessions. Essentially, negotiation would have forced Canada to sacrifice the well-being of one of its industries to retain a viable periodical industry. Consequently, for Canada this alternative had the tendency of curing one problem while at the same time causing another problem.

For the United States, the main drawback to negotiating a settlement was that *Sports Illustrated Canada* and other potential U.S. split-run periodical publishers would continue to be completely banned from the Canadian market. As a result, the United States was hesitant to agree to this type of resolution. Canada would have had to provide trade concessions enormously favorable to the United States for this alternative to succeed. Thus, negotiation would not have been a very desirable alternative for either country.

## 2. *Canada's Options After the Panel and Appellate Body Decisions*

At the present time, the key for Canada is to devise a method of ensuring its periodical industry's viability while also satisfying its GATT obligations. One option for Canada is to make the subsidy payments directly to the Canadian publishers. Based on the Appellate Body's decision on this issue, a direct subsidy would assuredly constitute a permissible subsidy under Article III:8(b).<sup>232</sup> One advantage of this course of action is that it would keep the prices of the Canadian periodicals lower, which would definitely benefit Canadian periodical purchasers. Obviously, the less Canadian periodical purchasers are required to spend on a periodical, the more likely they are to purchase it.

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232. See *supra* notes 193-200.

These lower prices would prevent a depression in the consumption of Canadian periodicals, which would directly benefit the Canadian periodical publishers. Strictly in terms of supply and demand, the direct subsidy is an attractive alternative.

A direct subsidy would also strengthen the Canadian government's long-standing claim that its true motivation for protecting Canada's cultural industries is the maintenance of a distinct Canadian culture.<sup>233</sup> A direct subsidy would demonstrate that this policy really is important to the Canadian government and not merely an attempt at economic protectionism, as the USTR has consistently characterized it.<sup>234</sup> In addition, a direct subsidy would place the Canadian government's policy of protecting its culture out in the open and provide the Canadian public with an opportunity to scrutinize it. Strong support from the Canadian public certainly would further justify this policy's position in the Canadian government.

The main drawback to a direct subsidy is that the Canadian public may not support it. The Canadian public may conclude that the Canadian government should not be spending Canadian tax dollars in this fashion. This type of response from the Canadian public, though, is unlikely to occur. Currently, approximately sixty-two percent of the Canadian public believes that the Canadian government should provide some type of support for Canadian culture.<sup>235</sup> Based on this figure, it appears that the Canadian public would support the payment of a direct subsidy to the Canadian periodical publishers.

Another drawback to a direct subsidy is that the Canadian government must provide a substantial amount of funding to the Canadian periodical publishers. If Canada had not previously "subsidized" the industry,<sup>236</sup> this funding requirement could be a significant impediment to providing a direct subsidy. Canada's prior "subsidization" of the periodical industry, though, demonstrates that it possesses the resources necessary to provide a direct subsidy to the periodical industry.

If the Canadian public concludes that a direct subsidy is not a viable alternative, the Canadian government could decide to simply remove all of its culture-protecting policies and allow direct competition within the Canadian periodical market. This course of action would force Canadian periodicals to either be-

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233. See *supra* notes 11-15 and accompanying text.

234. See *supra* note 16-18 and accompanying text.

235. See *supra* note 11.

236. See *supra* note 49.

come more efficient or risk losing their share of the Canadian periodical market. The pressure of direct competition would probably improve the quality of Canadian periodicals because direct competition would force continuous improvement in order for Canadian publishers to compete with foreign periodical publishers.

Assuming Canadian publishers could overcome their current inefficiencies, this course of action could provide the best long-term solution for the Canadian periodical industry. Canadian publishers would no longer rely on support from the Canadian government. Instead, they would be self-reliant, which would remove the governmental component, and its accompanying constant changes in policy, from the equation. Allowing direct competition in the periodical market could also benefit the Canadian government. Because it would not be funding the Canadian periodical industry, a substantial amount of money<sup>237</sup> would be available to support a different industry.

The results of allowing direct competition in the Canadian periodical market, however, are uncertain. It is a strong possibility that Canadian publishers do not possess the resources necessary to make such a drastic transition.<sup>238</sup> As a result, direct competition could cause a substantial number of Canadian periodicals to discontinue publication, clearly not the result desired by the Canadian government. Therefore, because the direct subsidy option is available and provides a certain amount of stability in the currently unstable Canadian periodical industry, it is probably the best option for the Canadian government at this time. Canada would still have the option of allowing direct competition in the periodical industry at some point in the future, should the Canadian periodical industry become more financially stable.

### C. WTO v. NAFTA

The USTR's decision to resolve this dispute in the WTO will influence the resolution of future trade disputes. It is important to note that *Sports Illustrated Canada* was not an imported split-run periodical, because it was actually printed in Canada.<sup>239</sup> Only the editorial content, which Time Warner sent to Canada via satellite, was imported into Canada.<sup>240</sup> Conse-

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237. *Id.*

238. *See supra* notes 24-31.

239. *See infra* note 78 and accompanying text.

240. *Id.*

quently, the United States' challenge to the Excise Tax was based on the hypothetical imported split-run periodicals that would be harmed by the Excise Tax absent Canada's protectionist measures. Under GATT, this challenge was clearly permissible, because Article III protects competitive conditions.<sup>241</sup> Thus, no actual injury is required for an Article III violation to occur. Instead, only the competitive conditions must be injured, which they clearly were in the current dispute.<sup>242</sup> The Import Ban, Excise Tax, and favorable postal rates obviously served to tip the competitive conditions in favor of the Canadian periodicals.

According to the USTR, the main reason it decided to resolve the dispute in the WTO was that a WTO resolution could influence a much broader range of countries.<sup>243</sup> A WTO resolution would apply to all Member countries in any subsequent disputes involving cultural products. Conversely, a resolution under NAFTA could have been used only against Canada and Mexico—obviously not the broad application the United States desired.

For the USTR, another disadvantage of using NAFTA is that its resolutions are nonbinding.<sup>244</sup> Under NAFTA, the dispute had the potential to continue for many years, because Canada could have ignored any NAFTA resolution and proceeded to invoke its measures on the imported split-run periodicals. In contrast, WTO rulings are binding.<sup>245</sup> The WTO would enable the United States to secure a resolution enforceable against the Canadian government. Thus, support is also present for the USTR's assertion that the WTO provided a more concrete basis upon which to resolve a dispute.

While the WTO's breadth of coverage and binding resolution mechanism may have provided advantages for the United States, the circumstances of the controversy demonstrate the real reason the United States chose this forum. A significant reason the United States chose the WTO was because the Canadian measures did not violate Canada's obligations under NAFTA. In fact, NAFTA's cultural exemption<sup>246</sup> granted Can-

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241. See *supra* notes 167-68 and accompanying text.

242. NAFTA incorporates GATT's national treatment provisions into it. Thus, like GATT, only an injury to competitive conditions is necessary to violate NAFTA's national treatment provisions. NAFTA, art. 301.

243. See *U.S. Initiates WTO Case Over Canadian Split-Run Policies, Postal Rates*, *supra* note 96, at 7.

244. NAFTA, art. 2018.

245. DSU, art. 21.

246. See *supra* note 46.



ada the power to maintain the Import Ban, enact the Excise Tax, and administer the favorable postal rates. Because Canada's regulation of the periodical industry was entirely consistent with NAFTA's requirements, a challenge under NAFTA was essentially foreclosed. Consequently, the United States was forced to use the WTO if it wanted to successfully challenge the Canadian measures.

Because GATT contains no cultural exemption,<sup>247</sup> using the WTO enabled the United States to circumvent the cultural exemption that Canada had fought so hard to have included in NAFTA. In the WTO, Canada's measures would be required to conform with the relevant GATT provisions, including Article III's national treatment requirements. For all practical purposes, using the WTO to resolve this dispute would render NAFTA's cultural exemption virtually nonexistent. Thus, contrary to its asserted reason, the USTR's choice of the WTO was actually a strategic determination undertaken to circumvent NAFTA's cultural exemption.

Because of the proliferation of regional trade agreements, the forum shopping engaged in by the United States in the *Sports Illustrated Canada* controversy could become a constant problem in the international dispute resolution arena. To combat this problem in the future, GATT should be modified. A provision should be added stating that if a country agrees to a provision in a regional trade agreement that is GATT-consistent, but is not specifically provided for in GATT, then GATT cannot be used to resolve the dispute. Instead, the dispute must be resolved under the regional agreement. A provision such as this would substantially cut down the potential to utilize one trade agreement to avoid the obligations of another trade agreement. At the very least, this would provide some certainty in an uncertain area of trade that is becoming more important with the increase in regional trade agreements. Countries would be more confident that the obligations they negotiate in an agreement would not be circumvented through the use of GATT.

#### IV. CONCLUSION

In the *Sports Illustrated Canada* controversy, Canada struck out in its attempt to protect its periodical industry from imported split-run periodicals. By and large, the decisions rendered by the Panel and Appellate Body in *Canada—Certain*

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247. See *supra* notes 47-48.

*Measures Concerning Periodicals* appear to be GATT-consistent. The Appellate Body's determination that the funded postal rates contravene Article III:8(b), however, arguably constituted an erroneous decision rendered solely on policy grounds. The Appellate Body's conclusion substantially increases administrative costs without providing any substantive benefit. It merely results in a change in the form of the subsidy and not its substance.

Presently, the best course of action for the Canadian government to pursue is the payment of a subsidy directly to the Canadian publishers. This would be GATT-consistent, providing the Canadian public with an opportunity to determine if this is an appropriate governmental policy. Furthermore, it would provide support to the Canadian government's claims that its real intention has always been to maintain a separate and distinct Canadian culture.

The resolution of the *Canada—Certain Measures Concerning Periodicals* dispute is certain to have a far-reaching impact on the resolution of future trade disputes, especially those involving bilateral and multilateral trade agreements between WTO Member countries. Through its decision to resolve this dispute in the WTO, the United States essentially nullified NAFTA's cultural exemption. In the future, other countries will attempt to employ similar strategies to avoid unfavorable provisions contained in regional agreements. Thus, GATT should be modified to prevent this type of forum shopping in the future.

