



# REGIONAL COURSES IN INTERNATIONAL LAW

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## STUDY MATERIALS PART VII

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REGIONAL COURSES  
IN INTERNATIONAL LAW

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INTERNATIONAL TRADE LAW  
PROFESSOR MAKANE MOÏSE MBENGUE

Codification Division of the United Nations Office of Legal Affairs

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**INTERNATIONAL TRADE LAW**  
**PROFESSOR MAKANE MOÏSE MBENGUE**

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**Agreement Establishing the World Trade  
Organization, 1994**

## AGREEMENT ESTABLISHING THE WORLD TRADE ORGANIZATION

The *Parties* to this Agreement,

*Recognizing* that their relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development,

*Recognizing* further that there is need for positive efforts designed to ensure that developing countries, and especially the least developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development,

*Being desirous* of contributing to these objectives by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international trade relations,

*Resolved*, therefore, to develop an integrated, more viable and durable multilateral trading system encompassing the General Agreement on Tariffs and Trade, the results of past trade liberalization efforts, and all of the results of the Uruguay Round of Multilateral Trade Negotiations,

*Determined* to preserve the basic principles and to further the objectives underlying this multilateral trading system,

*Agree* as follows:



### *Article I*

#### *Establishment of the Organization*

The World Trade Organization (hereinafter referred to as "the WTO") is hereby established.

### *Article II*

#### *Scope of the WTO*

1. The WTO shall provide the common institutional framework for the conduct of trade relations among its Members in matters related to the agreements and associated legal instruments included in the Annexes to this Agreement.

2. The agreements and associated legal instruments included in Annexes 1, 2 and 3 (hereinafter referred to as "Multilateral Trade Agreements") are integral parts of this Agreement, binding on all Members.

3. The agreements and associated legal instruments included in Annex 4 (hereinafter referred to as "Plurilateral Trade Agreements") are also part of this Agreement for those Members that have

accepted them, and are binding on those Members. The Plurilateral Trade Agreements do not create either obligations or rights for Members that have not accepted them.

4. The General Agreement on Tariffs and Trade 1994 as specified in Annex 1A (hereinafter referred to as "GATT 1994") is legally distinct from the General Agreement on Tariffs and Trade, dated 30 October 1947, annexed to the Final Act Adopted at the Conclusion of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment, as subsequently rectified, amended or modified (hereinafter referred to as "GATT 1947").

### *Article III*

#### *Functions of the WTO*

1. The WTO shall facilitate the implementation, administration and operation, and further the objectives, of this Agreement and of the Multilateral Trade Agreements, and shall also provide the framework for the implementation, administration and operation of the Plurilateral Trade Agreements.

2. The WTO shall provide the forum for negotiations among its Members concerning their multilateral trade relations in matters dealt with under the agreements in the Annexes to this Agreement. The WTO may also provide a forum for further negotiations among its Members concerning their multilateral trade relations, and a framework for the implementation of the results of such negotiations, as may be decided by the Ministerial Conference.

3. The WTO shall administer the Understanding on Rules and Procedures Governing the Settlement of Disputes (hereinafter referred to as the "Dispute Settlement Understanding" or "DSU") in Annex 2 to this Agreement.

4. The WTO shall administer the Trade Policy Review Mechanism (hereinafter referred to as the "TPRM") provided for in Annex 3 to this Agreement.

5. With a view to achieving greater coherence in global economic policy-making, the WTO shall cooperate, as appropriate, with the International Monetary Fund and with the International Bank for Reconstruction and Development and its affiliated agencies.

### *Article IV*

#### *Structure of the WTO*

1. There shall be a Ministerial Conference composed of representatives of all the Members, which shall meet at least once every two years. The Ministerial Conference shall carry out the functions of the WTO and take actions necessary to this effect. The Ministerial Conference shall have the authority to take decisions on all matters under any of the Multilateral Trade Agreements, if so requested by a Member, in accordance with the specific requirements for decision-making in this Agreement and in the relevant Multilateral Trade Agreement.

2. There shall be a General Council composed of representatives of all the Members, which shall meet as appropriate. In the intervals between meetings of the Ministerial Conference, its functions shall be conducted by the General Council. The General Council shall also carry out the functions assigned to it by this Agreement. The General Council shall establish its rules of procedure and approve the rules of procedure for the Committees provided for in paragraph 7.

3. The General Council shall convene as appropriate to discharge the responsibilities of the Dispute Settlement Body provided for in the Dispute Settlement Understanding. The Dispute Settlement Body may have its own chairman and shall establish such rules of procedure as it deems necessary for the fulfilment of those responsibilities.

4. The General Council shall convene as appropriate to discharge the responsibilities of the Trade Policy Review Body provided for in the TPRM. The Trade Policy Review Body may have its own chairman and shall establish such rules of procedure as it deems necessary for the fulfilment of those responsibilities.

5. There shall be a Council for Trade in Goods, a Council for Trade in Services and a Council for Trade-Related Aspects of Intellectual Property Rights (hereinafter referred to as the "Council for TRIPS"), which shall operate under the general guidance of the General Council. The Council for Trade in Goods shall oversee the functioning of the Multilateral Trade Agreements in Annex 1A. The Council for Trade in Services shall oversee the functioning of the General Agreement on Trade in Services (hereinafter referred to as "GATS"). The Council for TRIPS shall oversee the functioning of the Agreement on Trade-Related Aspects of Intellectual Property Rights (hereinafter referred to as the "Agreement on TRIPS"). These Councils shall carry out the functions assigned to them by their respective agreements and by the General Council. They shall establish their respective rules of procedure subject to the approval of the General Council. Membership in these Councils shall be open to representatives of all Members. These Councils shall meet as necessary to carry out their functions.

6. The Council for Trade in Goods, the Council for Trade in Services and the Council for TRIPS shall establish subsidiary bodies as required. These subsidiary bodies shall establish their respective rules of procedure subject to the approval of their respective Councils.

7. The Ministerial Conference shall establish a Committee on Trade and Development, a Committee on Balance-of-Payments Restrictions and a Committee on Budget, Finance and Administration, which shall carry out the functions assigned to them by this Agreement and by the Multilateral Trade Agreements, and any additional functions assigned to them by the General Council, and may establish such additional Committees with such functions as it may deem appropriate. As part of its functions, the Committee on Trade and Development shall periodically review the special provisions in the Multilateral Trade Agreements in favour of the least-developed country Members and report to the General Council for appropriate action. Membership in these Committees shall be open to representatives of all Members.

8. The bodies provided for under the Plurilateral Trade Agreements shall carry out the functions assigned to them under those Agreements and shall operate within the institutional framework of the WTO. These bodies shall keep the General Council informed of their activities on a regular basis.

#### *Article V*

##### *Relations with Other Organizations*

1. The General Council shall make appropriate arrangements for effective cooperation with other intergovernmental organizations that have responsibilities related to those of the WTO.

2. The General Council may make appropriate arrangements for consultation and cooperation with non-governmental organizations concerned with matters related to those of the WTO.

#### *Article VI*

##### *The Secretariat*

1. There shall be a Secretariat of the WTO (hereinafter referred to as "the Secretariat") headed by a Director-General.

2. The Ministerial Conference shall appoint the Director-General and adopt regulations setting out the powers, duties, conditions of service and term of office of the Director-General.

3. The Director-General shall appoint the members of the staff of the Secretariat and determine their duties and conditions of service in accordance with regulations adopted by the Ministerial Conference.

4. The responsibilities of the Director-General and of the staff of the Secretariat shall be exclusively international in character. In the discharge of their duties, the Director-General and the staff of the Secretariat shall not seek or accept instructions from any government or any other authority external to the WTO. They shall refrain from any action which might adversely reflect on their position as international officials. The Members of the WTO shall respect the international character of the responsibilities of the Director-General and of the staff of the Secretariat and shall not seek to influence them in the discharge of their duties.

#### *Article VII*

##### *Budget and Contributions*

1. The Director-General shall present to the Committee on Budget, Finance and Administration the annual budget estimate and financial statement of the WTO. The Committee on Budget, Finance and Administration shall review the annual budget estimate and the financial statement presented by the Director-General and make recommendations thereon to the General Council. The annual budget estimate shall be subject to approval by the General Council.

2. The Committee on Budget, Finance and Administration shall propose to the General Council financial regulations which shall include provisions setting out:

(a) the scale of contributions apportioning the expenses of the WTO among its Members; and

(b) the measures to be taken in respect of Members in arrears.

The financial regulations shall be based, as far as practicable, on the regulations and practices of GATT 1947.

3. The General Council shall adopt the financial regulations and the annual budget estimate by a two-thirds majority comprising more than half of the Members of the WTO.

4. Each Member shall promptly contribute to the WTO its share in the expenses of the WTO in accordance with the financial regulations adopted by the General Council.

### Article VIII

#### *Status of the WTO*

1. The WTO shall have legal personality, and shall be accorded by each of its Members such legal capacity as may be necessary for the exercise of its functions.
2. The WTO shall be accorded by each of its Members such privileges and immunities as are necessary for the exercise of its functions.
3. The officials of the WTO and the representatives of the Members shall similarly be accorded by each of its Members such privileges and immunities as are necessary for the independent exercise of their functions in connection with the WTO.
4. The privileges and immunities to be accorded by a Member to the WTO, its officials, and the representatives of its Members shall be similar to the privileges and immunities stipulated in the Convention on the Privileges and Immunities of the Specialized Agencies, approved by the General Assembly of the United Nations on 21 November 1947.
5. The WTO may conclude a headquarters agreement.

### Article IX

#### *Decision-Making*

1. The WTO shall continue the practice of decision-making by consensus followed under GATT 1947.<sup>1</sup> Except as otherwise provided, where a decision cannot be arrived at by consensus, the matter at issue shall be decided by voting. At meetings of the Ministerial Conference and the General Council, each Member of the WTO shall have one vote. Where the European Communities exercise their right to vote, they shall have a number of votes equal to the number of their member States<sup>2</sup> which are Members of the WTO. Decisions of the Ministerial Conference and the General Council shall be taken by a majority of the votes cast, unless otherwise provided in this Agreement or in the relevant Multilateral Trade Agreement.<sup>3</sup>
2. The Ministerial Conference and the General Council shall have the exclusive authority to adopt interpretations of this Agreement and of the Multilateral Trade Agreements. In the case of an interpretation of a Multilateral Trade Agreement in Annex 1, they shall exercise their authority on the basis of a recommendation by the Council overseeing the functioning of that Agreement. The decision to adopt an interpretation shall be taken by a three-fourths majority of the Members. This paragraph shall not be used in a manner that would undermine the amendment provisions in Article X.
3. In exceptional circumstances, the Ministerial Conference may decide to waive an obligation imposed on a Member by this Agreement or any of the Multilateral Trade Agreements, provided that

<sup>1</sup>The body concerned shall be deemed to have decided by consensus on a matter submitted for its consideration, if no Member, present at the meeting when the decision is taken, formally objects to the proposed decision.

<sup>2</sup>The number of votes of the European Communities and their member States shall in no case exceed the number of the member States of the European Communities.

<sup>3</sup>Decisions by the General Council when convened as the Dispute Settlement Body shall be taken only in accordance with the provisions of paragraph 4 of Article 2 of the Dispute Settlement Understanding.

any such decision shall be taken by three fourths<sup>4</sup> of the Members unless otherwise provided for in this paragraph.

- (a) A request for a waiver concerning this Agreement shall be submitted to the Ministerial Conference for consideration pursuant to the practice of decision-making by consensus. The Ministerial Conference shall establish a time-period, which shall not exceed 90 days, to consider the request. If consensus is not reached during the time-period, any decision to grant a waiver shall be taken by three fourths<sup>4</sup> of the Members.
- (b) A request for a waiver concerning the Multilateral Trade Agreements in Annexes 1A or 1B or 1C and their annexes shall be submitted initially to the Council for Trade in Goods, the Council for Trade in Services or the Council for TRIPS, respectively, for consideration during a time-period which shall not exceed 90 days. At the end of the time-period, the relevant Council shall submit a report to the Ministerial Conference.
4. A decision by the Ministerial Conference granting a waiver shall state the exceptional circumstances justifying the decision, the terms and conditions governing the application of the waiver, and the date on which the waiver shall terminate. Any waiver granted for a period of more than one year shall be reviewed by the Ministerial Conference not later than one year after it is granted, and thereafter annually until the waiver terminates. In each review, the Ministerial Conference shall examine whether the exceptional circumstances justifying the waiver still exist and whether the terms and conditions attached to the waiver have been met. The Ministerial Conference, on the basis of the annual review, may extend, modify or terminate the waiver.
5. Decisions under a Plurilateral Trade Agreement, including any decisions on interpretations and waivers, shall be governed by the provisions of that Agreement.

### Article X

#### *Amendments*

1. Any Member of the WTO may initiate a proposal to amend the provisions of this Agreement or the Multilateral Trade Agreements in Annex 1 by submitting such proposal to the Ministerial Conference. The Councils listed in paragraph 5 of Article IV may also submit to the Ministerial Conference proposals to amend the provisions of the corresponding Multilateral Trade Agreements in Annex 1 the functioning of which they oversee. Unless the Ministerial Conference decides on a longer period, for a period of 90 days after the proposal has been tabled formally at the Ministerial Conference any decision by the Ministerial Conference to submit the proposed amendment to the Members for acceptance shall be taken by consensus. Unless the provisions of paragraphs 2, 5 or 6 apply, that decision shall specify whether the provisions of paragraphs 3 or 4 shall apply. If consensus is reached, the Ministerial Conference shall forthwith submit the proposed amendment to the Members for acceptance. If consensus is not reached at a meeting of the Ministerial Conference within the established period, the Ministerial Conference shall decide by a two-thirds majority of the Members whether to submit the proposed amendment to the Members for acceptance. Except as provided in paragraphs 2, 5 and 6, the provisions of paragraph 3 shall apply to the proposed amendment, unless the Ministerial Conference decides by a three-fourths majority of the Members that the provisions of paragraph 4 shall apply.
2. Amendments to the provisions of this Article and to the provisions of the following Articles shall take effect only upon acceptance by all Members:

<sup>4</sup>A decision to grant a waiver in respect of any obligation subject to a transition period or a period for staged implementation that the requesting Member has not performed by the end of the relevant period shall be taken only by consensus.

Article IX of this Agreement;  
 Articles I and II of GATT 1994;  
 Article II:1 of GATS;  
 Article 4 of the Agreement on TRIPS.

3. Amendments to provisions of this Agreement, or of the Multilateral Trade Agreements in Annexes IA and IC, other than those listed in paragraphs 2 and 6, of a nature that would alter the rights and obligations of the Members, shall take effect for the Members that have accepted them upon acceptance by two thirds of the Members and thereafter for each other Member upon acceptance by it. The Ministerial Conference may decide by a three-fourths majority of the Members that any amendment made effective under this paragraph is of such a nature that any Member which has not accepted it within a period specified by the Ministerial Conference in each case shall be free to withdraw from the WTO or to remain a Member with the consent of the Ministerial Conference.
4. Amendments to provisions of this Agreement or of the Multilateral Trade Agreements in Annexes IA and IC, other than those listed in paragraphs 2 and 6, of a nature that would not alter the rights and obligations of the Members, shall take effect for all Members upon acceptance by two thirds of the Members.
5. Except as provided in paragraph 2 above, amendments to Parts I, II and III of GATS and the respective annexes shall take effect for the Members that have accepted them upon acceptance by two thirds of the Members and thereafter for each Member upon acceptance by it. The Ministerial Conference may decide by a three-fourths majority of the Members that any amendment made effective under the preceding provision is of such a nature that any Member which has not accepted it within a period specified by the Ministerial Conference in each case shall be free to withdraw from the WTO or to remain a Member with the consent of the Ministerial Conference. Amendments to Parts IV, V and VI of GATS and the respective annexes shall take effect for all Members upon acceptance by two thirds of the Members.
6. Notwithstanding the other provisions of this Article, amendments to the Agreement on TRIPS meeting the requirements of paragraph 2 of Article 71 thereof may be adopted by the Ministerial Conference without further formal acceptance process.
7. Any Member accepting an amendment to this Agreement or to a Multilateral Trade Agreement in Annex 1 shall deposit an instrument of acceptance with the Director-General of the WTO within the period of acceptance specified by the Ministerial Conference.
8. Any Member of the WTO may initiate a proposal to amend the provisions of the Multilateral Trade Agreements in Annexes 2 and 3 by submitting such proposal to the Ministerial Conference. The decision to approve amendments to the Multilateral Trade Agreement in Annex 2 shall be made by consensus and these amendments shall take effect for all Members upon approval by the Ministerial Conference. Decisions to approve amendments to the Multilateral Trade Agreement in Annex 3 shall take effect for all Members upon approval by the Ministerial Conference.
9. The Ministerial Conference, upon the request of the Members parties to a trade agreement, may decide exclusively by consensus to add that agreement to Annex 4. The Ministerial Conference, upon the request of the Members parties to a Plurilateral Trade Agreement, may decide to delete that Agreement from Annex 4.
10. Amendments to a Plurilateral Trade Agreement shall be governed by the provisions of that Agreement.

*Article XI*  
*Original Membership*

1. The contracting parties to GATT 1947 as of the date of entry into force of this Agreement, and the European Communities, which accept this Agreement and the Multilateral Trade Agreements and for which Schedules of Concessions and Commitments are annexed to GATT 1994 and for which Schedules of Specific Commitments are annexed to GATS shall become original Members of the WTO.
  2. The least-developed countries recognized as such by the United Nations will only be required to undertake commitments and concessions to the extent consistent with their individual development, financial and trade needs or their administrative and institutional capabilities.
- Article XII*  
*Accession*
1. Any State or separate customs territory possessing full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement and the Multilateral Trade Agreements may accede to this Agreement, on terms to be agreed between it and the WTO. Such accession shall apply to this Agreement and the Multilateral Trade Agreements annexed thereto.
  2. Decisions on accession shall be taken by the Ministerial Conference. The Ministerial Conference shall approve the agreement on the terms of accession by a two-thirds majority of the Members of the WTO.
  3. Accession to a Plurilateral Trade Agreement shall be governed by the provisions of that Agreement.

*Article XIII*

*Non-Application of Multilateral Trade Agreements  
 between Particular Members*

1. This Agreement and the Multilateral Trade Agreements in Annexes 1 and 2 shall not apply as between any Member and any other Member if either of the Members, at the time either becomes a Member, does not consent to such application.
2. Paragraph 1 may be invoked between original Members of the WTO which were contracting parties to GATT 1947 only where Article XXXV of that Agreement had been invoked earlier and was effective as between those contracting parties at the time of entry into force for them of this Agreement.
3. Paragraph 1 shall apply between a Member and another Member which has acceded under Article XII only if the Member not consenting to the application has so notified the Ministerial Conference before the approval of the agreement on the terms of accession by the Ministerial Conference.
4. The Ministerial Conference may review the operation of this Article in particular cases at the request of any Member and make appropriate recommendations.
5. Non-application of a Plurilateral Trade Agreement between parties to that Agreement shall be governed by the provisions of that Agreement.

*Article XIV*

*Acceptance, Entry into Force and Deposit*

1. This Agreement shall be open for acceptance, by signature or otherwise, by contracting parties to GATT 1947, and the European Communities, which are eligible to become original Members of the WTO in accordance with Article XI of this Agreement. Such acceptance shall apply to this Agreement and the Multilateral Trade Agreements annexed hereto. This Agreement and the Multilateral Trade Agreements annexed hereto shall enter into force on the date determined by Ministers in accordance with paragraph 3 of the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations and shall remain open for acceptance for a period of two years following that date unless the Ministers decide otherwise. An acceptance following the entry into force of this Agreement shall enter into force on the 30th day following the date of such acceptance.

2. A Member which accepts this Agreement after its entry into force shall implement those concessions and obligations in the Multilateral Trade Agreements that are to be implemented over a period of time starting with the entry into force of this Agreement as if it had accepted this Agreement on the date of its entry into force.

3. Until the entry into force of this Agreement, the text of this Agreement and the Multilateral Trade Agreements shall be deposited with the Director-General to the CONTRACTING PARTIES to GATT 1947. The Director-General shall promptly furnish a certified true copy of this Agreement and the Multilateral Trade Agreements, and a notification of each acceptance thereof, to each government and the European Communities having accepted this Agreement. This Agreement and the Multilateral Trade Agreements, and any amendments thereto, shall, upon the entry into force of this Agreement, be deposited with the Director-General of the WTO.

4. The acceptance and entry into force of a Plurilateral Trade Agreement shall be governed by the provisions of that Agreement. Such Agreements shall be deposited with the Director-General to the CONTRACTING PARTIES to GATT 1947. Upon the entry into force of this Agreement, such Agreements shall be deposited with the Director-General of the WTO.

*Article XV*

*Withdrawal*

1. Any Member may withdraw from this Agreement. Such withdrawal shall apply both to this Agreement and the Multilateral Trade Agreements and shall take effect upon the expiration of six months from the date on which written notice of withdrawal is received by the Director-General of the WTO.
2. Withdrawal from a Plurilateral Trade Agreement shall be governed by the provisions of that Agreement.

*Article XVI*

*Miscellaneous Provisions*

1. Except as otherwise provided under this Agreement or the Multilateral Trade Agreements, the WTO shall be guided by the decisions, procedures and customary practices followed by the CONTRACTING PARTIES to GATT 1947 and the bodies established in the framework of GATT 1947.

2. To the extent practicable, the Secretariat of GATT 1947 shall become the Secretariat of the WTO, and the Director-General to the CONTRACTING PARTIES to GATT 1947, until such time as the Ministerial Conference has appointed a Director-General in accordance with paragraph 2 of Article VI of this Agreement, shall serve as Director-General of the WTO.

3. In the event of a conflict between a provision of this Agreement and a provision of any of the Multilateral Trade Agreements, the provision of this Agreement shall prevail to the extent of the conflict.

4. Each Member shall ensure the conformity of its laws, regulations and administrative procedures with its obligations as provided in the annexed Agreements.

5. No reservations may be made in respect of any provision of this Agreement. Reservations in respect of any of the provisions of the Multilateral Trade Agreements may only be made to the extent provided for in those Agreements. Reservations in respect of a provision of a Plurilateral Trade Agreement shall be governed by the provisions of that Agreement.

6. This Agreement shall be registered in accordance with the provisions of Article 102 of the Charter of the United Nations.

DONE at Marrakesh this fifteenth day of April one thousand nine hundred and ninety-four, in a single copy, in the English, French and Spanish languages, each text being authentic.

**Explanatory Notes:**

The terms "country" or "countries" as used in this Agreement and the Multilateral Trade Agreements are to be understood to include any separate customs territory Member of the WTO.

In the case of a separate customs territory Member of the WTO, where an expression in this Agreement and the Multilateral Trade Agreements is qualified by the term "national", such expression shall be read as pertaining to that customs territory, unless otherwise specified.

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**General Agreement on Tariffs and Trade, 1947  
(now incorporated into GATT 1994)**

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The Governments of the COMMONWEALTH OF AUSTRALIA, the KINGDOM OF BELGIUM, the UNITED STATES OF BRAZIL, BURMA, CANADA, CEYLON, the REPUBLIC OF CHILE, the REPUBLIC OF CHINA, the REPUBLIC OF CUBA, the CZECHOSLOVAK REPUBLIC, the FRENCH REPUBLIC, INDIA, LEBANON, the GRAND-DUCHY OF LUXEMBURG, the KINGDOM OF THE NETHERLANDS, NEW ZEALAND, the KINGDOM OF NORWAY, PAKISTAN, SOUTHERN RHODESIA, SYRIA, the UNION OF SOUTH AFRICA, the UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND, and the UNITED STATES OF AMERICA:

Recognizing that their relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, developing the full use of the resources of the world and expanding the production and exchange of goods,

Being desirous of contributing to these objectives by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce,

Have through their Representatives agreed as follows:

## PART I

### *Article I: General Most-Favoured-Nation Treatment*

1. With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III,\* any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.
2. The provisions of paragraph 1 of this Article shall not require the elimination of any preferences in respect of import duties or charges which do not exceed the levels provided for in paragraph 4 of this Article and which fall within the following descriptions:
  - (a) Preferences in force exclusively between two or more of the territories listed in Annex A, subject to the conditions set forth therein;
  - (b) Preferences in force exclusively between two or more territories which on July 1, 1939, were connected by common sovereignty or relations of protection or suzerainty and which are listed in Annexes B, C and D, subject to the conditions set forth therein;
  - (c) Preferences in force exclusively between the United States of America and the Republic of Cuba;
  - (d) Preferences in force exclusively between neighbouring countries listed in Annexes E and F.
3. The provisions of paragraph 1 shall not apply to preferences between the countries formerly a part of the Ottoman Empire and detached from it on July 24, 1923, provided such preferences are approved under paragraph 5<sup>1</sup> of Article XXV, which shall be applied in this respect in the light of paragraph 1 of Article XXIX.
4. The margin of preference\* on any product in respect of which a preference is permitted under paragraph 2 of this Article but is not specifically set forth as a maximum margin of preference in the appropriate Schedule annexed to this Agreement shall not exceed:
  - (a) in respect of duties or charges on any product described in such Schedule, the difference between the most-favoured-nation and preferential rates provided for therein; if no preferential rate is provided for, the preferential rate shall for the purposes of this paragraph be taken to be that in force on April 10, 1947, and, if no most-favoured-nation rate is provided for, the margin shall not exceed the difference between the most-favoured-nation and preferential rates existing on April 10, 1947;
  - (b) in respect of duties or charges on any product not described in the appropriate Schedule, the difference between the most-favoured-nation and preferential rates existing on April 10, 1947.

In the case of the contracting parties named in Annex G, the date of April 10, 1947, referred to in sub-paragraph (a) and (b) of this paragraph shall be replaced by the respective dates set forth in that

<sup>1</sup> The authentic text erroneously reads "subparagraph 5 (a)".

Annex.

*Article II: Schedules of Concessions*

1. (a) Each contracting party shall accord to the commerce of the other contracting parties treatment no less favourable than that provided for in the appropriate Part of the appropriate Schedule annexed to this Agreement.
- (b) The products described in Part I of the Schedule relating to any contracting party, which are the products of territories of other contracting parties, shall, on their importation into the territory to which the Schedule relates, and subject to the terms, conditions or qualifications set forth in that Schedule, be exempt from ordinary customs duties in excess of those set forth and provided therein. Such products shall also be exempt from all other duties or charges of any kind imposed on or in connection with the importation in excess of those imposed on the date of this Agreement or those directly and mandatorily required to be imposed thereafter by legislation in force in the importing territory on that date.
- (c) The products described in Part II of the Schedule relating to any contracting party which are the products of territories entitled under Article I to receive preferential treatment upon importation into the territory to which the Schedule relates shall, on their importation into such territory, and subject to the terms, conditions or qualifications set forth in that Schedule, be exempt from ordinary customs duties in excess of those set forth and provided for in Part II of that Schedule. Such products shall also be exempt from all other duties or charges of any kind imposed on or in connection with importation in excess of those imposed on the date of this Agreement or those directly or mandatorily required to be imposed thereafter by legislation in force in the importing territory on that date. Nothing in this Article shall prevent any contracting party from maintaining its requirements existing on the date of this Agreement as to the eligibility of goods for entry at preferential rates of duty.

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party the treatment which the first contracting party believes to have been contemplated by a concession provided for in the appropriate Schedule annexed to this Agreement, it shall bring the matter directly to the attention of the other contracting party. If the latter agrees that the treatment contemplated was that claimed by the first contracting party, but declares that such treatment cannot be accorded because a court or other proper authority has ruled to the effect that the product involved cannot be classified under the tariff laws of such contracting party so as to permit the treatment contemplated in this Agreement, the two contracting parties, together with any other contracting parties substantially interested, shall enter promptly into further negotiations with a view to a compensatory adjustment of the matter.

6. (a) The specific duties and charges included in the Schedules relating to contracting parties members of the International Monetary Fund, and margins of preference in specific duties and charges maintained by such contracting parties, are expressed in the appropriate currency at the par value accepted or provisionally recognized by the Fund at the date of this Agreement. Accordingly, in case this par value is reduced consistently with the Articles of Agreement of the International Monetary Fund by more than twenty per centum, such specific duties and charges and margins of preference may be adjusted to take account of such reduction; *provided* that the CONTRACTING PARTIES (*i.e.*, the contracting parties acting jointly as provided for in Article XXV) concur that such adjustments will not impair the value of the concessions provided for in the appropriate Schedule or elsewhere in this Agreement, due account being taken of all factors which may influence the need for, or urgency of, such adjustments.

(b) Similar provisions shall apply to any contracting party not a member of the Fund, as from the date on which such contracting party becomes a member of the Fund or enters into a special exchange agreement in pursuance of Article XV.

7. The Schedules annexed to this Agreement are hereby made an integral part of Part I of this Agreement.

**PART II**

*Article III\*: National Treatment on Internal Taxation and Regulation*

1. 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.\*
2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no 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.\*
3. With respect to any existing internal tax which is inconsistent with the provisions of paragraph 2, but which is specifically authorized under a trade agreement, in force on April 10, 1947, in which the import duty on the taxed product is bound against increase, the contracting party imposing the tax shall be free to postpone the application of the provisions of paragraph 2 to such tax until such time as it can obtain release from the obligations of such trade agreement in order to permit the increase of such duty to the extent necessary to compensate for the elimination of the protective element of the tax.

2. Nothing in this Article shall prevent any contracting party from imposing at any time on the importation of any product:
  - (a) a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III\* in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part;
  - (b) any anti-dumping or countervailing duty applied consistently with the provisions of Article VI\*;
  - (c) fees or other charges commensurate with the cost of services rendered.
3. No contracting party shall alter its method of determining dutiable value or of converting currencies so as to impair the value of any of the concessions provided for in the appropriate Schedule annexed to this Agreement.
4. If any contracting party establishes, maintains or authorizes, formally or in effect, a monopoly of the importation of any product described in the appropriate Schedule annexed to this Agreement, such monopoly shall not, except as provided for in that Schedule or as otherwise agreed between the parties which initially negotiated the concession, operate so as to afford protection on the average in excess of the amount of protection provided for in that Schedule. The provisions of this paragraph shall not limit the use by contracting parties of any form of assistance to domestic producers permitted by other provisions of this Agreement.\*
5. If any contracting party considers that a product is not receiving from another contracting

4. 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.

5. No contracting party shall establish or maintain any internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions which requires, directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources. Moreover, no contracting party shall otherwise apply internal quantitative regulations in a manner contrary to the principles set forth in paragraph 1.\*

6. The provisions of paragraph 5 shall not apply to any internal quantitative regulation in force in the territory of any contracting party on July 1, 1939, April 10, 1947, or March 24, 1948, at the option of that contracting party; *Provided* that any such regulation which is contrary to the provisions of paragraph 5 shall not be modified to the detriment of imports and shall be treated as a customs duty for the purpose of negotiation.

7. No internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions shall be applied in such a manner as to allocate any such amount or proportion among external sources of supply.

8. (a) The provisions of this Article shall not apply to laws, regulations or requirements governing the procurement by governmental agencies of products purchased for governmental purposes and not with a view to commercial resale or with a view to use in the production of goods for commercial sale.

(b) The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, 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.

9. The contracting parties recognize that internal maximum price control measures, even though conforming to the other provisions of this Article, can have effects prejudicial to the interests of contracting parties supplying imported products. Accordingly, contracting parties applying such measures shall take account of the interests of exporting contracting parties with a view to avoiding to the fullest practicable extent such prejudicial effects.

10. The provisions of this Article shall not prevent any contracting party from establishing or maintaining internal quantitative regulations relating to exposed cinematograph films and meeting the requirements of Article IV.

#### *Article IV: Special Provisions relating to Cinematograph Films*

If any contracting party establishes or maintains internal quantitative regulations relating to exposed cinematograph films, such regulations shall take the form of screen quotas which shall conform to the following requirements:

(a) Screen quotas may require the exhibition of cinematograph films of national origin during a specified minimum proportion of the total screen time actually utilized, over a specified period of not less than one year, in the commercial exhibition of all films of whatever

origin, and shall be computed on the basis of screen time per theatre per year or the equivalent thereof;

(b) With the exception of screen time reserved for films of national origin under a screen quota, screen time including that released by administrative action from screen time reserved for films of national origin, shall not be allocated formally or in effect among sources of supply;

(c) Notwithstanding the provisions of sub-paragraph (b) of this Article, any contracting party may maintain screen quotas conforming to the requirements of sub-paragraph (a) of this Article which reserve a minimum proportion of screen time for films of a specified origin other than that of the contracting party imposing such screen quotas; *Provided* that no such minimum proportion of screen time shall be increased above the level in effect on April 10, 1947;

(d) Screen quotas shall be subject to negotiation for their limitation, liberalization or elimination.

#### *Article V: Freedom of Transit*

1. Goods (including baggage), and also vessels and other means of transport, shall be deemed to be in transit across the territory of a contracting party when the passage across such territory, with or without trans-shipment, warehousing, breaking bulk, or change in the mode of transport, is only a portion of a complete journey beginning and terminating beyond the frontier of the contracting party across whose territory the traffic passes. Traffic of this nature is termed in this article "traffic in transit".

2. There shall be freedom of transit through the territory of each contracting party, via the routes most convenient for international transit, for traffic in transit to or from the territory of other contracting parties. No distinction shall be made which is based on the flag of vessels, the place of origin, departure, entry, exit or destination, or on any circumstances relating to the ownership of goods, of vessels or of other means of transport.

3. Any contracting party may require that traffic in transit through its territory be entered at the proper custom house, but, except in cases of failure to comply with applicable customs laws and regulations, such traffic coming from or going to the territory of other contracting parties shall not be subject to any unnecessary delays or restrictions and shall be exempt from customs duties and from all transit duties or other charges imposed in respect of transit, except charges for transportation or those commensurate with administrative expenses entailed by transit or with the cost of services rendered.

4. All charges and regulations imposed by contracting parties on traffic in transit to or from the territories of other contracting parties shall be reasonable, having regard to the conditions of the traffic.

5. With respect to all charges, regulations and formalities in connection with transit, each contracting party shall accord to traffic in transit to or from the territory of any other contracting party treatment no less favourable than the treatment accorded to traffic in transit to or from any third country.\*

6. Each contracting party shall accord to products which have been in transit through the territory of any other contracting party treatment no less favourable than that which would have been accorded to such products had they been transported from their place of origin to their

destination without going through the territory of such other contracting party. Any contracting party shall, however, be free to maintain its requirements of direct consignment existing on the date of this Agreement, in respect of any goods in regard to which such direct consignment is a requisite condition of eligibility for entry of the goods at preferential rates of duty or has relation to the contracting party's prescribed method of valuation for duty purposes.

7. The provisions of this Article shall not apply to the operation of aircraft in transit, but shall apply to air transit of goods (including baggage).

*Article VI: Anti-dumping and Countervailing Duties*

1. The contracting parties recognize that dumping, by which products of one country are introduced into the commerce of another country at less than the normal value of the products, is to be condemned if it causes or threatens material injury to an established industry in the territory of a contracting party or materially retards the establishment of a domestic industry. For the purposes of this Article, a product is to be considered as being introduced into the commerce of an importing country at less than its normal value, if the price of the product exported from one country to another

(a) is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country, or,

(b) in the absence of such domestic price, is less than either

- (i) the highest comparable price for the like product for export to any third country in the ordinary course of trade, or
- (ii) the cost of production of the product in the country of origin plus a reasonable addition for selling cost and profit.

Due allowance shall be made in each case for differences in conditions and terms of sale, for differences in taxation, and for other differences affecting price comparability.\*

2. In order to offset or prevent dumping, a contracting party may levy on any dumped product an anti-dumping duty not greater in amount than the margin of dumping in respect of such product. For the purposes of this Article, the margin of dumping is the price difference determined in accordance with the provisions of paragraph 1.\*

3. No countervailing duty shall be levied on any product of the territory of any contracting party imported into the territory of another contracting party in excess of an amount equal to the estimated bounty or subsidy determined to have been granted, directly or indirectly, on the manufacture, production or export of such product in the country of origin or exportation, including any special subsidy to the transportation of a particular product. The term "countervailing duty" shall be understood to mean a special duty levied for the purpose of offsetting any bounty or subsidy bestowed, directly, or indirectly, upon the manufacture, production or export of any merchandise.\*

4. No product of the territory of any contracting party imported into the territory of any other contracting party shall be subject to anti-dumping or countervailing duty by reason of the exemption of such product from duties or taxes borne by the like product when destined for consumption in the country of origin or exportation, or by reason of the refund of such duties or taxes.

5. No product of the territory of any contracting party imported into the territory of any other contracting party shall be subject to both anti-dumping and countervailing duties to compensate for the same situation of dumping or export subsidization.

6. (a) No contracting party shall levy any anti-dumping or countervailing duty on the importation of any product of the territory of another contracting party unless it determines that the effect of the dumping or subsidization, as the case may be, is such as to cause or threaten material injury to an established domestic industry, or is such as to retard materially the establishment of a domestic industry.

(b) The CONTRACTING PARTIES may waive the requirement of sub-paragraph (a) of this paragraph so as to permit a contracting party to levy an anti-dumping or countervailing duty on the importation of any product for the purpose of offsetting dumping or subsidization which causes or threatens material injury to an industry in the territory of another contracting party exporting the product concerned to the territory of the importing contracting party. The CONTRACTING PARTIES shall waive the requirements of sub-paragraph (a) of this paragraph, so as to permit the levying of a countervailing duty, in cases in which they find that a subsidy is causing or threatening material injury to an industry in the territory of another contracting party exporting the product concerned to the territory of the importing contracting party.\*

(c) In exceptional circumstances, however, where delay might cause damage which would be difficult to repair, a contracting party may levy a countervailing duty for the purpose referred to in sub-paragraph (b) of this paragraph without the prior approval of the CONTRACTING PARTIES; *Provided* that such action shall be reported immediately to the CONTRACTING PARTIES and that the countervailing duty shall be withdrawn promptly if the CONTRACTING PARTIES disapprove.

7. A system for the stabilization of the domestic price or of the return to domestic producers of a primary commodity, independently of the movements of export prices, which results at times in the sale of the commodity for export at a price lower than the comparable price charged for the like commodity to buyers in the domestic market, shall be presumed not to result in material injury within the meaning of paragraph 6 if it is determined by consultation among the contracting parties substantially interested in the commodity concerned that:

- (a) the system has also resulted in the sale of the commodity for export at a price higher than the comparable price charged for the like commodity to buyers in the domestic market, and
- (b) the system is so operated, either because of the effective regulation of production, or otherwise, as not to stimulate exports unduly or otherwise seriously prejudice the interests of other contracting parties.

*Article VII: Valuation for Customs Purposes*

1. The contracting parties recognize the validity of the general principles of valuation set forth in the following paragraphs of this Article, and they undertake to give effect to such principles, in respect of all products subject to duties or other charges\* or restrictions on importation and exportation based upon or regulated in any manner by value. Moreover, they shall, upon a request by another contracting party review the operation of any of their laws or regulations relating to value for customs purposes in the light of these principles. The CONTRACTING PARTIES may request from contracting parties reports on steps taken by them in pursuance of the provisions of this Article.

2. (a) The value for customs purposes of imported merchandise should be based on the actual value of the imported merchandise on which duty is assessed, or of like merchandise, and should not be based on the value of merchandise of national origin or on arbitrary or fictitious values.\*

(b) "Actual value" should be the price at which, at a time and place determined by the legislation of the country of importation, such or like merchandise is sold or offered for sale in the ordinary course of trade under fully competitive conditions. To the extent to which the price of such

or like merchandise is governed by the quantity in a particular transaction, the price to be considered should uniformly be related to either (i) comparable quantities, or (ii) quantities not less favourable to importers than those in which the greater volume of the merchandise is sold in the trade between the countries of exportation and importation.\*

(c) When the actual value is not ascertainable in accordance with sub-paragraph (b) of this paragraph, the value for customs purposes should be based on the nearest ascertainable equivalent of such value.\*

3. The value for customs purposes of any imported product should not include the amount of any internal tax, applicable within the country of origin or export, from which the imported product has been exempted or has been or will be relieved by means of refund.

4. (a) Except as otherwise provided for in this paragraph, where it is necessary for the purposes of paragraph 2 of this Article for a contracting party to convert into its own currency a price expressed in the currency of another country, the conversion rate of exchange to be used shall be based, for each currency involved, on the par value as established pursuant to the Articles of Agreement of the International Monetary Fund or on the rate of exchange recognized by the Fund, or on the par value established in accordance with a special exchange agreement entered into pursuant to Article XV of this Agreement.

(b) Where no such established par value and no such recognized rate of exchange exist, the conversion rate shall reflect effectively the current value of such currency in commercial transactions.

(c) The CONTRACTING PARTIES, in agreement with the International Monetary Fund, shall formulate rules governing the conversion by contracting parties of any foreign currency in respect of which multiple rates of exchange are maintained consistently with the Articles of Agreement of the International Monetary Fund. Any contracting party may apply such rules in respect of such foreign currencies for the purposes of paragraph 2 of this Article as an alternative to the use of par values. Until such rules are adopted by the CONTRACTING PARTIES, any contracting party may employ, in respect of any such foreign currency, rules of conversion for the purposes of paragraph 2 of this Article which are designed to reflect effectively the value of such foreign currency in commercial transactions.

(d) Nothing in this paragraph shall be construed to require any contracting party to alter the method of converting currencies for customs purposes which is applicable in its territory on the date of this Agreement, if such alteration would have the effect of increasing generally the amounts of duty payable.

5. The bases and methods for determining the value of products subject to duties or other charges or restrictions based upon or regulated in any manner by value should be stable and should be given sufficient publicity to enable traders to estimate, with a reasonable degree of certainty, the value for customs purposes.

#### *Article VIII: Fees and Formalities connected with Importation and Exportation\**

1. (a) All fees and charges of whatever character (other than import and export duties and other than taxes within the purview of Article III) imposed by contracting parties on or in connection with importation or exportation shall be limited in amount to the approximate cost of services rendered and shall not represent an indirect protection to domestic products or a taxation of imports or exports for fiscal purposes.

(b) The contracting parties recognize the need for reducing the number and diversity of

fees and charges referred to in sub-paragraph (a).

(c) The contracting parties also recognize the need for minimizing the incidence and complexity of import and export formalities and for decreasing and simplifying import and export documentation requirements.\*

2. A contracting party shall, upon request by another contracting party or by the CONTRACTING PARTIES, review the operation of its laws and regulations in the light of the provisions of this Article.

3. No contracting party shall impose substantial penalties for minor breaches of customs regulations or procedural requirements. In particular, no penalty in respect of any omission or mistake in customs documentation which is easily rectifiable and obviously made without fraudulent intent or gross negligence shall be greater than necessary to serve merely as a warning.

4. The provisions of this Article shall extend to fees, charges, formalities and requirements imposed by governmental authorities in connection with importation and exportation, including those relating to:

- (a) consular transactions, such as consular invoices and certificates;
- (b) quantitative restrictions;
- (c) licensing;
- (d) exchange control;
- (e) statistical services;
- (f) documents, documentation and certification;
- (g) analysis and inspection; and
- (h) quarantine, sanitation and fumigation.

#### *Article IX: Marks of Origin*

1. Each contracting party shall accord to the products of the territories of other contracting parties treatment with regard to marking requirements no less favourable than the treatment accorded to like products of any third country.

2. The contracting parties recognize that, in adopting and enforcing laws and regulations relating to marks of origin, the difficulties and inconveniences which such measures may cause to the commerce and industry of exporting countries should be reduced to a minimum, due regard being had to the necessity of protecting consumers against fraudulent or misleading indications.

3. Whenever it is administratively practicable to do so, contracting parties should permit required marks of origin to be affixed at the time of importation.

4. The laws and regulations of contracting parties relating to the marking of imported products shall be such as to permit compliance without seriously damaging the products, or materially reducing their value, or unreasonably increasing their cost.

5. As a general rule, no special duty or penalty should be imposed by any contracting party for failure to comply with marking requirements prior to importation unless corrective marking is unreasonably delayed or deceptive marks have been affixed or the required marking has been intentionally omitted.

6. The contracting parties shall co-operate with each other with a view to preventing the use of trade names in such manner as to misrepresent the true origin of a product, to the detriment of such distinctive regional or geographical names of products of the territory of a contracting party as

are protected by its legislation. Each contracting party shall accord full and sympathetic consideration to such requests or representations as may be made by any other contracting party regarding the application of the undertaking set forth in the preceding sentence to names of products which have been communicated to it by the other contracting party.

*Article X: Publication and Administration of Trade Regulations*

1. Laws, regulations, judicial decisions and administrative rulings of general application, made effective by any contracting party, pertaining to the classification or the valuation of products for customs purposes, or to rates of duty, taxes or other charges, or to requirements, restrictions or prohibitions on imports or exports or on the transfer of payments therefor, or affecting their sale, distribution, transportation, insurance, warehousing, inspection, exhibition, processing, mixing or other use, shall be published promptly in such a manner as to enable governments and traders to become acquainted with them. Agreements affecting international trade policy which are in force between the government or a governmental agency of any contracting party and the government or governmental agency of any other contracting party shall also be published. The provisions of this paragraph shall not require any contracting party to disclose confidential information which would impede law enforcement or otherwise be contrary to the public interest or would prejudice the legitimate commercial interests of particular enterprises, public or private.

2. No measure of general application taken by any contracting party effecting an advance in a rate of duty or other charge on imports under an established and uniform practice, or imposing a new or more burdensome requirement, restriction or prohibition on imports, or on the transfer of payments therefor, shall be enforced before such measure has been officially published.

3. (a) Each contracting party shall administer in a uniform, impartial and reasonable manner all its laws, regulations, decisions and rulings of the kind described in paragraph 1 of this Article.

(b) Each contracting party shall maintain, or institute as soon as practicable, judicial, arbitral or administrative tribunals or procedures for the purpose, *inter alia*, of the prompt review and correction of administrative action relating to customs matters. Such tribunals or procedures shall be independent of the agencies entrusted with administrative enforcement and their decisions shall be implemented by, and shall govern the practice of, such agencies unless an appeal is lodged with a court or tribunal of superior jurisdiction within the time prescribed for appeals to be lodged by importers; *Provided* that the central administration of such agency may take steps to obtain a review of the matter in another proceeding if there is good cause to believe that the decision is inconsistent with established principles of law or the actual facts.

(c) The provisions of sub-paragraph (b) of this paragraph shall not require the elimination or substitution of procedures in force in the territory of a contracting party on the date of this Agreement which in fact provide for an objective and impartial review of administrative action even though such procedures are not fully or formally independent of the agencies entrusted with administrative enforcement. Any contracting party employing such procedures shall, upon request, furnish the CONTRACTING PARTIES with full information thereon in order that they may determine whether such procedures conform to the requirements of this sub-paragraph.

*Article XI\*: General Elimination of Quantitative Restrictions*

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

2. The provisions of paragraph 1 of this Article shall not extend to the following:

- (a) Export prohibitions or restrictions temporarily applied to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting contracting party;
- (b) Import and export prohibitions or restrictions necessary to the application of standards or regulations for the classification, grading or marketing of commodities in international trade;
- (c) Import restrictions on any agricultural or fisheries product, imported in any form,\* necessary to the enforcement of governmental measures which operate:
  - (i) to restrict the quantities of the like domestic product permitted to be marketed or produced, or, if there is no substantial domestic production of the like product, of a domestic product for which the imported product for which the imported product can be directly substituted; or
  - (ii) to remove a temporary surplus of the like domestic product, or, if there is no substantial domestic production of the like product, of a domestic product for which the imported product can be directly substituted, by making the surplus available to certain groups of domestic consumers free of charge or at prices below the current market level; or
  - (iii) to restrict the quantities permitted to be produced of any animal product the production of which is directly dependent, wholly or mainly, on the imported commodity, if the domestic production of that commodity is relatively negligible.

Any contracting party applying restrictions on the importation of any product pursuant to sub-paragraph (c) of this paragraph shall give public notice of the total quantity or value of the product permitted to be imported during a specified future period and of any change in such quantity or value. Moreover, any restrictions applied under (i) above shall not be such as will reduce the total of imports relative to the total of domestic production, as compared with the proportion which might reasonably be expected to rule between the two in the absence of restrictions. In determining this proportion, the contracting party shall pay due regard to the proportion prevailing during a previous representative period and to any special factors\* which may have affected or may be affecting the trade in the product concerned.

*Article XII\*: Restrictions to Safeguard the Balance of Payments*

1. Notwithstanding the provisions of paragraph 1 of Article XI, any contracting party, in order to safeguard its external financial position and its balance of payments, may restrict the quantity or value of merchandise permitted to be imported, subject to the provisions of the following paragraphs of this Article.

2. (a) Import restrictions instituted, maintained or intensified by a contracting party under this Article shall not exceed those necessary:

- (i) to forestall the imminent threat of, or to stop, a serious decline in its monetary reserves, or
- (ii) in the case of a contracting party with very low monetary reserves, to achieve a reasonable rate of increase in its reserves.

Due regard shall be paid in either case to any special factors which may be affecting the reserves of such contracting party or its need for reserves, including, where special external credits or other

resources are available to it, the need to provide for the appropriate use of such credits or resources.

(b) Contracting parties applying restrictions under sub-paragraph (a) of this paragraph shall progressively relax them as such conditions improve, maintaining them only to the extent that the conditions specified in that sub-paragraph still justify their application. They shall eliminate the restrictions when conditions would no longer justify their institution or maintenance under that sub-paragraph.

3. (a) Contracting parties undertake, in carrying out their domestic policies, to pay due regard to the need for maintaining or restoring equilibrium in their balance of payments on a sound and lasting basis and to the desirability of avoiding an uneconomic employment of productive resources. They recognize that, in order to achieve these ends, it is desirable so far as possible to adopt measures which expand rather than contract international trade.

(b) Contracting parties applying restrictions under this Article may determine the incidence of the restrictions on imports of different products or classes of products in such a way as to give priority to the importation of those products which are more essential.

(c) Contracting parties applying restrictions under this Article undertake:

(i) to avoid unnecessary damage to the commercial or economic interests of any other contracting party;\*

(ii) not to apply restrictions so as to prevent unreasonably the importation of any description of goods in minimum commercial quantities the exclusion of which would impair regular channels of trade; and

(iii) not to apply restrictions which would prevent the importations of commercial samples or prevent compliance with patent, trade mark, copyright, or similar procedures.

(d) The contracting parties recognize that, as a result of domestic policies directed towards the achievement and maintenance of full and productive employment or towards the development of economic resources, a contracting party may experience a high level of demand for imports involving a threat to its monetary reserves of the sort referred to in paragraph 2 (a) of this Article. Accordingly, a contracting party otherwise complying with the provisions of this Article shall not be required to withdraw or modify restrictions on the ground that a change in those policies would render unnecessary restrictions which it is applying under this Article.

4. (a) Any contracting party applying new restrictions or raising the general level of its existing restrictions by a substantial intensification of the measures applied under this Article shall immediately after instituting or intensifying such restrictions (or, in circumstances in which prior consultation is practicable, before doing so) consult with the CONTRACTING PARTIES as to the nature of its balance of payments difficulties, alternative corrective measures which may be available, and the possible effect of the restrictions on the economies of other contracting parties.

(b) On a date to be determined by them,\* the CONTRACTING PARTIES shall review all restrictions still applied under this Article on that date. Beginning one year after that date, contracting parties applying import restrictions under this Article shall enter into consultations of the type provided for in sub-paragraph (c) of this paragraph with the CONTRACTING PARTIES annually.

(c) (i) If, in the course of consultations with a contracting party under sub-paragraph (a) or (b) above, the CONTRACTING PARTIES find that the restrictions are not consistent with provisions of this Article or with those of Article XIII (subject to the provisions of Article XIV), they shall

indicate the nature of the inconsistency and may advise that the restrictions be suitably modified.

(ii) If, however, as a result of the consultations, the CONTRACTING PARTIES determine that the restrictions are being applied in a manner involving an inconsistency of a serious nature with the provisions of this Article or with those of Article XIII (subject to the provisions of Article XIV) and that damage to the trade of any contracting party is caused or threatened thereby, they shall so inform the contracting party applying the restrictions and shall make appropriate recommendations for securing conformity with such provisions within the specified period of time. If such contracting party does not comply with these recommendations within the specified period, the CONTRACTING PARTIES may release any contracting party the trade of which is adversely affected by the restrictions from such obligations under this Agreement towards the contracting party applying the restrictions as they determine to be appropriate in the circumstances.

(d) The CONTRACTING PARTIES shall invite any contracting party which is applying restrictions under this Article to enter into consultations with them at the request of any contracting party which can establish a *prima facie* case that the restrictions are inconsistent with the provisions of this Article or with those of Article XIII (subject to the provisions of Article XIV) and that its trade is adversely affected thereby. However, no such invitation shall be issued unless the CONTRACTING PARTIES have ascertained that direct discussions between the contracting parties concerned have not been successful. If, as a result of the consultations with the CONTRACTING PARTIES, no agreement is reached and they determine that the restrictions are being applied inconsistently with such provisions, and that damage to the trade of the contracting party initiating the procedure is caused or threatened thereby, they shall recommend the withdrawal or modification of the restrictions. If the restrictions are not withdrawn or modified within such time as the CONTRACTING PARTIES may prescribe, they may release the contracting party initiating the procedure from such obligations under this Agreement towards the contracting party applying the restrictions as they determine to be appropriate in the circumstances.

(e) In proceeding under this paragraph, the CONTRACTING PARTIES shall have due regard to any special external factors adversely affecting the export trade of the contracting party applying the restrictions.\*

(f) Determinations under this paragraph shall be rendered expeditiously and, if possible, within sixty days of the initiation of the consultations.

5. If there is a persistent and widespread application of import restrictions under this Article, indicating the existence of a general disequilibrium which is restricting international trade, the CONTRACTING PARTIES shall initiate discussions to consider whether other measures might be taken, either by those contracting parties the balance of payments of which are under pressure or by those the balance of payments of which are tending to be exceptionally favourable, or by any appropriate intergovernmental organization, to remove the underlying causes of the disequilibrium. On the invitation of the CONTRACTING PARTIES, contracting parties shall participate in such discussions.

#### Article XIII\*: Non-discriminatory Administration of Quantitative Restrictions

1. No prohibition or restriction shall be applied by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation of any product destined for the territory of any other contracting party, unless the importation of the like product of all third countries or the exportation of the like product to all third countries is similarly prohibited or restricted.

2. In applying import restrictions to any product, contracting parties shall aim at a distribution of trade in such product approaching as closely as possible the shares which the various contracting

parties might be expected to obtain in the absence of such restrictions and to this end shall observe the following provisions:

- (a) Wherever practicable, quotas representing the total amount of permitted imports (whether allocated among supplying countries or not) shall be fixed, and notice given of their amount in accordance with paragraph 3 (b) of this Article;
- (b) In cases in which quotas are not practicable, the restrictions may be applied by means of import licences or permits without a quota;
- (c) Contracting parties shall not, except for purposes of operating quotas allocated in accordance with sub-paragraph (d) of this paragraph, require that import licences or permits be utilized for the importation of the product concerned from a particular country or source;
- (d) In cases in which a quota is allocated among supplying countries the contracting party applying the restrictions may seek agreement with respect to the allocation of shares in the quota with all other contracting parties having a substantial interest in supplying the product concerned. In cases in which this method is not reasonably practicable, the contracting party concerned shall allot to contracting parties having a substantial interest in supplying the product shares based upon the proportions, supplied by such contracting parties during a previous representative period, of the total quantity or value of imports of the product, due account being taken of any special factors which may have affected or may be affecting the trade in the product. No conditions or formalities shall be imposed which would prevent any contracting party from utilizing fully the share of any such total quantity or value which has been allotted to it, subject to importation being made within any prescribed period to which the quota may relate.\*

3. (a) In cases in which import licences are issued in connection with import restrictions, the contracting party applying the restrictions shall provide, upon the request of any contracting party having an interest in the trade in the product concerned, all relevant information concerning the administration of the restrictions, the import licences granted over a recent period and the distribution of such licences among supplying countries; *Provided* that there shall be no obligation to supply information as to the names of importing or supplying enterprises.

(b) In the case of import restrictions involving the fixing of quotas, the contracting party applying the restrictions shall give public notice of the total quantity or value of the product or products which will be permitted to be imported during a specified future period and of any change in such quantity or value. Any supplies of the product in question which were *en route* at the time at which public notice was given shall not be excluded from entry; *Provided* that they may be counted so far as practicable, against the quantity permitted to be imported in the period in question, and also, where necessary, against the quantities permitted to be imported in the next following period or periods; and *Provided* further that if any contracting party customarily exempts from such restrictions products entered for consumption or withdrawn from warehouse for consumption during a period of thirty days after the day of such public notice, such practice shall be considered full compliance with this sub-paragraph.

(c) In the case of quotas allocated among supplying countries, the contracting party applying the restrictions shall promptly inform all other contracting parties having an interest in supplying the product concerned of the shares in the quota currently allocated, by quantity or value, to the various supplying countries and shall give public notice thereof.

4. With regard to restrictions applied in accordance with paragraph 2 (d) of this Article or under paragraph 2 (c) of Article XI, the selection of a representative period for any product and the appraisal of any special factors\* affecting the trade in the product shall be made initially by the

contracting party applying the restriction; *Provided* that such contracting party shall, upon the request of any other contracting party having a substantial interest in supplying that product or upon the request of the CONTRACTING PARTIES, consult promptly with the other contracting party or the CONTRACTING PARTIES regarding the need for an adjustment of the proportion determined or of the base period selected, or for the reappraisal of the special factors involved, or for the elimination of conditions, formalities or any other provisions established unilaterally relating to the allocation of an adequate quota or its unrestricted utilization.

5. The provisions of this Article shall apply to any tariff quota instituted or maintained by any contracting party, and, in so far as applicable, the principles of this Article shall also extend to export restrictions.

*Article XIV\*<sup>a</sup>: Exceptions to the Rule of Non-discrimination*

1. A contracting party which applies restrictions under Article XII or under Section B of Article XVIII may, in the application of such restrictions, deviate from the provisions of Article XIII in a manner having equivalent effect to restrictions on payments and transfers for current international transactions which that contracting party may at that time apply under Article VIII or XIV of the Articles of Agreement of the International Monetary Fund, or under analogous provisions of a special exchange agreement entered into pursuant to paragraph 6 of Article XV.\*

2. A contracting party which is applying import restrictions under Article XII or under Section B of Article XVIII may, with the consent of the CONTRACTING PARTIES, temporarily deviate from the provisions of Article XIII in respect of a small part of its external trade where the benefits to the contracting party or contracting parties concerned substantially outweigh any injury which may result to the trade of other contracting parties.\*

3. The provisions of Article XIII shall not preclude a group of territories having a common quota in the International Monetary Fund from applying against imports from other countries, but not among themselves, restrictions in accordance with the provisions of Article XII or of Section B of Article XVIII on condition that such restrictions are in all other respects consistent with the provisions of Article XIII.

4. A contracting party applying import restrictions under Article XII or under Section B of Article XVIII shall not be precluded by Articles XI to XV or Section B of Article XVIII of this Agreement from applying measures to direct its exports in such a manner as to increase its earnings of currencies which it can use without deviation from the provisions of Article XIII.

5. A contracting party shall not be precluded by Articles XI to XV, inclusive, or by Section B of Article XVIII, of this Agreement from applying quantitative restrictions:

- (a) having equivalent effect to exchange restrictions authorized under Section 3 (b) of Article VII of the Articles of Agreement of the International Monetary Fund, or
- (b) under the preferential arrangements provided for in Annex A of this Agreement, pending the outcome of the negotiations referred to therein.

*Article XV: Exchange Arrangements*

1. The CONTRACTING PARTIES shall seek co-operation with the International Monetary Fund to the end that the CONTRACTING PARTIES and the Fund may pursue a co-ordinated policy with regard to exchange questions within the jurisdiction of the Fund and questions of quantitative restrictions and other trade measures within the jurisdiction of the CONTRACTING PARTIES.

2. In all cases in which the CONTRACTING PARTIES are called upon to consider or deal with problems concerning monetary reserves, balances of payments or foreign exchange arrangements, they shall consult fully with the International Monetary Fund. In such consultations, the CONTRACTING PARTIES shall accept all findings of statistical and other facts presented by the Fund relating to foreign exchange, monetary reserves and balances of payments, and shall accept the determination of the Fund as to whether action by a contracting party in exchange matters is in accordance with the Articles of Agreement of the International Monetary Fund, or with the terms of a special exchange agreement between that contracting party and the CONTRACTING PARTIES. The CONTRACTING PARTIES in reaching their final decision in cases involving the criteria set forth in paragraph 2 (a) of Article XII or in paragraph 9 of Article XVIII, shall accept the determination of the Fund as to what constitutes a serious decline in the contracting party's monetary reserves, a very low level of its monetary reserves or a reasonable rate of increase in its monetary reserves, and as to the financial aspects of other matters covered in consultation in such cases.

3. The CONTRACTING PARTIES shall seek agreement with the Fund regarding procedures for consultation under paragraph 2 of this Article.

4. Contracting parties shall not, by exchange action, frustrate\* the intent of the provisions of this Agreement, nor, by trade action, the intent of the provisions of the Articles of Agreement of the International Monetary Fund.

5. If the CONTRACTING PARTIES consider, at any time, that exchange restrictions on payments and transfers in connection with imports are being applied by a contracting party in a manner inconsistent with the exceptions provided for in this Agreement for quantitative restrictions, they shall report thereon to the Fund.

6. Any contracting party which is not a member of the Fund shall, within a time to be determined by the CONTRACTING PARTIES after consultation with the Fund, become a member of the Fund, or, failing that, enter into a special exchange agreement with the CONTRACTING PARTIES. A contracting party which ceases to be a member of the Fund shall forthwith enter into a special exchange agreement with the CONTRACTING PARTIES. Any special exchange agreement entered into by a contracting party under this paragraph shall thereupon become part of its obligations under this Agreement.

7. (a) A special exchange agreement between a contracting party and the CONTRACTING PARTIES under paragraph 6 of this Article shall provide to the satisfaction of the CONTRACTING PARTIES that the objectives of this Agreement will not be frustrated as a result of action in exchange matters by the contracting party in question.

(b) The terms of any such agreement shall not impose obligations on the contracting party in exchange matters generally more restrictive than those imposed by the Articles of Agreement of the International Monetary Fund on members of the Fund.

8. A contracting party which is not a member of the Fund shall furnish such information within the general scope of section 5 of Article VIII of the Articles of Agreement of the International Monetary Fund as the CONTRACTING PARTIES may require in order to carry out their functions under this Agreement.

9. Nothing in this Agreement shall preclude:

(a) the use by a contracting party of exchange controls or exchange restrictions in accordance with the Articles of Agreement of the International Monetary Fund or with that contracting party's special exchange agreement with the CONTRACTING PARTIES, or

(b) the use by a contracting party of restrictions or controls in imports or exports, the sole effect of which, additional to the effects permitted under Articles XI, XII, XIII and XIV, is to make effective such exchange controls or exchange restrictions.

#### *Article XVI\**: Subsidies

##### Section A - Subsidies in General

1. If any contracting party grants or maintains any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory, it shall notify the CONTRACTING PARTIES in writing of the extent and nature of the subsidization, of the estimated effect of the subsidization on the quantity of the affected product or products imported into or exported from its territory and of the circumstances making the subsidization necessary. In any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by any such subsidization, the contracting party granting the subsidy shall, upon request, discuss with the other contracting party or parties concerned, or with the CONTRACTING PARTIES, the possibility of limiting the subsidization.

##### Section B - Additional Provisions on Export Subsidies\*

2. The contracting parties recognize that the granting by a contracting party of a subsidy on the export of any product may have harmful effects for other contracting parties, both importing and exporting, may cause undue disturbance to their normal commercial interests, and may hinder the achievement of the objectives of this Agreement.

3. Accordingly, contracting parties should seek to avoid the use of subsidies on the export of primary products. If, however, a contracting party grants directly or indirectly any form of subsidy which operates to increase the export of any primary product from its territory, such subsidy shall not be applied in a manner which results in that contracting party having more than an equitable share of world export trade in that product, account being taken of the shares of the contracting parties in such trade in the product during a previous representative period, and any special factors which may have affected or may be affecting such trade in the product.\*

4. Further, as from 1 January 1958 or the earliest practicable date thereafter, contracting parties shall cease to grant either directly or indirectly any form of subsidy on the export of any product other than a primary product which subsidy results in the sale of such product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market. Until 31 December 1957 no contracting party shall extend the scope of any such subsidization beyond that existing on 1 January 1955 by the introduction of new, or the extension of existing, subsidies.\*

5. The CONTRACTING PARTIES shall review the operation of the provisions of this Article from time to time with a view to examining its effectiveness, in the light of actual experience, in promoting the objectives of this Agreement and avoiding subsidization seriously prejudicial to the trade or interests of contracting parties.

#### *Article XVII: State Trading Enterprises*

1. (a) Each contracting party undertakes that if it establishes or maintains a State enterprise, wherever located, or grants to any enterprise, formally or in effect, exclusive or special privileges,\* such enterprise shall, in its purchases or sales involving either imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement for governmental measures affecting imports or exports by private traders.

(b) The provisions of sub-paragraph (a) of this paragraph shall be understood to require that such enterprises shall, having due regard to the other provisions of this Agreement, make any such purchases or sales solely in accordance with commercial considerations,\* including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford the enterprises of the other contracting parties adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales.

(c) No contracting party shall prevent any enterprise (whether or not an enterprise described in sub-paragraph (a) of this paragraph) under its jurisdiction from acting in accordance with the principles of sub-paragraphs (a) and (b) of this paragraph.

2. The provisions of paragraph 1 of this Article shall not apply to imports of products for immediate or ultimate consumption in governmental use and not otherwise for resale or use in the production of goods\* for sale. With respect to such imports, each contracting party shall accord to the trade of the other contracting parties fair and equitable treatment.

3. The contracting parties recognize that enterprises of the kind described in paragraph 1 (a) of this Article might be operated so as to create serious obstacles to trade; thus negotiations on a reciprocal and mutually advantageous basis designed to limit or reduce such obstacles are of importance to the expansion of international trade.\*

4. (a) Contracting parties shall notify the CONTRACTING PARTIES of the products which are imported into or exported from their territories by enterprises of the kind described in paragraph 1 (a) of this Article.

(b) A contracting party establishing, maintaining or authorizing an import monopoly of a product, which is not the subject of a concession under Article II, shall, on the request of another contracting party having a substantial trade in the product concerned, inform the CONTRACTING PARTIES of the import mark-up\* on the product during a recent representative period, or, when it is not possible to do so, of the price charged on the resale of the product.

(c) The CONTRACTING PARTIES may, at the request of a contracting party which has reason to believe that its interest under this Agreement are being adversely affected by the operations of an enterprise of the kind described in paragraph 1 (a), request the contracting party establishing, maintaining or authorizing such enterprise to supply information about its operations related to the carrying out of the provisions of this Agreement.

(d) The provisions of this paragraph shall not require any contracting party to disclose confidential information which would impede law enforcement or otherwise be contrary to the public interest or would prejudice the legitimate commercial interests of particular enterprises.

#### *Article XVIII\*: Governmental Assistance to Economic Development*

1. The contracting parties recognize that the attainment of the objectives of this Agreement will be facilitated by the progressive development of their economies, particularly of those contracting parties the economies of which can only support low standards of living\* and are in the early stages of development.\*

2. The contracting parties recognize further that it may be necessary for those contracting parties, in order to implement programmes and policies of economic development designed to raise the general standard of living of their people, to take protective or other measures affecting imports, and that such measures are justified in so far as they facilitate the attainment of the objectives of this Agreement. They agree, therefore, that those contracting parties should enjoy additional facilities to

enable them (a) to maintain sufficient flexibility in their tariff structure to be able to grant the tariff protection required for the establishment of a particular industry\* and (b) to apply quantitative restrictions for balance of payments purposes in a manner which takes full account of the continued high level of demand for imports likely to be generated by their programmes of economic development.

3. The contracting parties recognize finally that, with those additional facilities which are provided for in Sections A and B of this Article, the provisions of this Agreement would normally be sufficient to enable contracting parties to meet the requirements of their economic development. They agree, however, that there may be circumstances where no measure consistent with those provisions is practicable to permit a contracting party in the process of economic development to grant the governmental assistance required to promote the establishment of particular industries\* with a view to raising the general standard of living of its people. Special procedures are laid down in Sections C and D of this Article to deal with those cases.

4. (a) Consequently, a contracting party, the economy of which can only support low standards of living\* and is in the early stages of development,\* shall be free to deviate temporarily from the provisions of the other Articles of this Agreement, as provided in Sections A, B and C of this Article.

(b) A contracting party, the economy of which is in the process of development, but which does not come within the scope of sub-paragraph (a) above, may submit applications to the CONTRACTING PARTIES under Section D of this Article.

5. The contracting parties recognize that the export earnings of contracting parties, the economies of which are of the type described in paragraph 4 (a) and (b) above and which depend on exports of a small number of primary commodities, may be seriously reduced by a decline in the sale of such commodities. Accordingly, when the exports of primary commodities by such a contracting party are seriously affected by measures taken by another contracting party, it may have resort to the consultation provisions of Article XXII of this Agreement.

6. The CONTRACTING PARTIES shall review annually all measures applied pursuant to the provisions of Sections C and D of this Article.

#### Section A

7. (a) If a contracting party coming within the scope of paragraph 4 (a) of this Article considers it desirable, in order to promote the establishment of a particular industry\* with a view to raising the general standard of living of its people, to modify or withdraw a concession included in the appropriate Schedule annexed to this Agreement, it shall notify the CONTRACTING PARTIES to this effect and enter into negotiations with any contracting party with which such concession was initially negotiated, and with any other contracting party determined by the CONTRACTING PARTIES to have a substantial interest therein. If agreement is reached between such contracting parties concerned, they shall be free to modify or withdraw concessions under the appropriate Schedules to this Agreement in order to give effect to such agreement, including any compensatory adjustments involved.

(b) If agreement is not reached within sixty days after the notification provided for in sub-paragraph (a) above, the contracting party which proposes to modify or withdraw the concession may refer the matter to the CONTRACTING PARTIES which shall promptly examine it. If they find that the contracting party which proposes to modify or withdraw the concession has made every effort to reach an agreement and that the compensatory adjustment offered by it is adequate, that contracting party shall be free to modify or withdraw the concession if, at the same time, it gives effect to the compensatory adjustment. If the CONTRACTING PARTIES do not find that the

compensation offered by a contracting party proposing to modify or withdraw the concession is adequate, but find that it has made every reasonable effort to offer adequate compensation, that contracting party shall be free to proceed with such modification or withdrawal. If such action is taken, any other contracting party referred to in sub-paragraph (a) above shall be free to modify or withdraw substantially equivalent concessions initially negotiated with the contracting party which has taken the action.\*

#### Section B

8. The contracting parties recognize that contracting parties coming within the scope of paragraph 4 (a) of this Article tend, when they are in rapid process of development, to experience balance of payments difficulties arising mainly from efforts to expand their internal markets as well as from the instability in their terms of trade.

9. In order to safeguard its external financial position and to ensure a level of reserves adequate for the implementation of its programme of economic development, a contracting party coming within the scope of paragraph 4 (a) of this Article may, subject to the provisions of paragraphs 10 to 12, control the general level of its imports by restricting the quantity or value of merchandise permitted to be imported; *Provided* that the import restrictions instituted, maintained or intensified shall not exceed those necessary:

- (a) to forestall the threat of, or to stop, a serious decline in its monetary reserves, or
- (b) in the case of a contracting party with inadequate monetary reserves, to achieve a reasonable rate of increase in its reserves.

Due regard shall be paid in either case to any special factors which may be affecting the reserves of the contracting party or its need for reserves, including, where special external credits or other resources are available to it, the need to provide for the appropriate use of such credits or resources.

10. In applying these restrictions, the contracting party may determine their incidence on imports of different products or classes of products in such a way as to give priority to the importation of those products which are more essential in the light of its policy of economic development; *Provided* that the restrictions are so applied as to avoid unnecessary damage to the commercial or economic interests of any other contracting party and not to prevent unreasonably the importation of any description of goods in minimum commercial quantities the exclusion of which would impair regular channels of trade; and *Provided* further that the restrictions are not so applied as to prevent the importation of commercial samples or to prevent compliance with patent, trade mark, copyright or similar procedures.

11. In carrying out its domestic policies, the contracting party concerned shall pay due regard to the need for restoring equilibrium in its balance of payments on a sound and lasting basis and to the desirability of assuring an economic employment of productive resources. It shall progressively relax any restrictions applied under this Section as conditions improve, maintaining them only to the extent necessary under the terms of paragraph 9 of this Article and shall eliminate them when conditions no longer justify such maintenance; *Provided* that no contracting party shall be required to withdraw or modify restrictions on the ground that a change in its development policy would render unnecessary the restrictions which it is applying under this Section.\*

12. (a) Any contracting party applying new restrictions or raising the general level of its existing restrictions by a substantial intensification of the measures applied under this Section, shall immediately after instituting or intensifying such restrictions (or, in circumstances in which prior consultation is practicable, before doing so) consult with the CONTRACTING PARTIES as to the nature of its balance of payments difficulties, alternative corrective measures which may be available, and

the possible effect of the restrictions on the economies of other contracting parties.

(b) On a date to be determined by them\* the CONTRACTING PARTIES shall review all restrictions still applied under this Section on that date. Beginning two years after that date, contracting parties applying restrictions under this Section shall enter into consultations of the type provided for in sub-paragraph (a) above with the CONTRACTING PARTIES at intervals of approximately, but not less than, two years according to a programme to be drawn up each year by the CONTRACTING PARTIES; *Provided* that no consultation under this sub-paragraph shall take place within two years after the conclusion of a consultation of a general nature under any other provision of this paragraph.

(c) (i) If, in the course of consultations with a contracting party under sub-paragraph (a) or (b) of this paragraph, the CONTRACTING PARTIES find that the restrictions are not consistent with the provisions of this Section or with those of Article XIII (subject to the provisions of Article XIV), they shall indicate the nature of the inconsistency and may advise that the restrictions be suitably modified.

(ii) If, however, as a result of the consultations, the CONTRACTING PARTIES determine that the restrictions are being applied in a manner involving an inconsistency of a serious nature with the provisions of this Section or with those of Article XIII (subject to the provisions of Article XIV) and that damage to the trade of any contracting party is caused or threatened thereby, they shall so inform the contracting party applying the restrictions and shall make appropriate recommendations for securing conformity with such provisions within a specified period. If such contracting party does not comply with these recommendations within the specified period, the CONTRACTING PARTIES may release any contracting party the trade of which is adversely affected by the restrictions from such obligations under this Agreement towards the contracting party applying the restrictions as they determine to be appropriate in the circumstances.

(d) The CONTRACTING PARTIES shall invite any contracting party which is applying restrictions under this Section to enter into consultations with them at the request of any contracting party which can establish a *prima facie* case that the restrictions are inconsistent with the provisions of this Section or with those of Article XIII (subject to the provisions of Article XIV) and that its trade is adversely affected thereby. However, no such invitation shall be issued unless the CONTRACTING PARTIES have ascertained that direct discussions between the contracting parties concerned have not been successful. If, as a result of the consultations with the CONTRACTING PARTIES no agreement is reached and they determine that the restrictions are being applied inconsistently with such provisions, and that damage to the trade of the contracting party initiating the procedure is caused or threatened thereby, they shall recommend the withdrawal or modification of the restrictions. If the restrictions are not withdrawn or modified within such time as the CONTRACTING PARTIES may prescribe, they may release the contracting party initiating the procedure from such obligations under this Agreement towards the contracting party applying the restrictions as they determine to be appropriate in the circumstances.

(e) If a contracting party against which action has been taken in accordance with the last sentence of sub-paragraph (c) (ii) or (d) of this paragraph, finds that the release of obligations authorized by the CONTRACTING PARTIES adversely affects the operation of its programme and policy of economic development, it shall be free, not later than sixty days after such action is taken, to give written notice to the Executive Secretary<sup>1</sup> to the CONTRACTING PARTIES of its intention to withdraw from this Agreement and such withdrawal shall take effect on the sixtieth day following the day on which the notice is received by him.

<sup>1</sup> By the Decision of 23 March 1965, the CONTRACTING PARTIES changed the title of the head of the GATT secretariat from "Executive Secretary" to "Director-General".

(f) In proceeding under this paragraph, the CONTRACTING PARTIES shall have due regard to the factors referred to in paragraph 2 of this Article. Determinations under this paragraph shall be rendered expeditiously and, if possible, within sixty days of the initiation of the consultations.

#### Section C

13. If a contracting party coming within the scope of paragraph 4 (a) of this Article finds that governmental assistance is required to promote the establishment of a particular industry\* with a view to raising the general standard of living of its people, but that no measure consistent with the other provisions of this Agreement is practicable to achieve that objective, it may have recourse to the provisions and procedures set out in this Section.\*

14. The contracting party concerned shall notify the CONTRACTING PARTIES of the special difficulties which it meets in the achievement of the objective outlined in paragraph 13 of this Article and shall indicate the specific measure affecting imports which it proposes to introduce in order to remedy these difficulties. It shall not introduce that measure before the expiration of the time-limit laid down in paragraph 15 or 17, as the case may be, or if the measure affects imports of a product which is the subject of a concession included in the appropriate Schedule annexed to this Agreement, unless it has secured the concurrence of the CONTRACTING PARTIES in accordance with paragraph 18; *Provided that*, if the industry receiving assistance has already started production, the contracting party may, after informing the CONTRACTING PARTIES, take such measures as may be necessary to prevent, during that period, imports of the product or products concerned from increasing substantially above a normal level.\*

15. If, within thirty days of the notification of the measure, the CONTRACTING PARTIES do not request the contracting party concerned to consult with them,\* that contracting party shall be free to deviate from the relevant provisions of the other Articles of this Agreement to the extent necessary to apply the proposed measure.

16. If it is requested by the CONTRACTING PARTIES to do so,\* the contracting party concerned shall consult with them as to the purpose of the proposed measure, as to alternative measures which may be available under this Agreement, and as to the possible effect of the measure proposed on the commercial and economic interests of other contracting parties. If, as a result of such consultation, the CONTRACTING PARTIES agree that there is no measure consistent with the other provisions of this Agreement which is practicable in order to achieve the objective outlined in paragraph 13 of this Article, and concur\* in the proposed measure, the contracting party concerned shall be released from its obligations under the relevant provisions of the other Articles of this Agreement to the extent necessary to apply that measure.

17. If, within ninety days after the date of the notification of the proposed measure under paragraph 14 of this Article, the CONTRACTING PARTIES have not concurred in such measure, the contracting party concerned may introduce the measure proposed after informing the CONTRACTING PARTIES.

18. If the proposed measure affects a product which is the subject of a concession included in the appropriate Schedule annexed to this Agreement, the contracting party concerned shall enter into consultations with any other contracting party with which the concession was initially negotiated, and with any other contracting party determined by the CONTRACTING PARTIES to have a substantial interest therein. The CONTRACTING PARTIES shall concur\* in the measure if they agree that there is no measure consistent with the other provisions of this Agreement which is practicable in order to achieve the objective set forth in paragraph 13 of this Article, and if they are satisfied:

(a) that agreement has been reached with such other contracting parties as a result of the consultations referred to above, or

(b) if no such agreement has been reached within sixty days after the notification provided for in paragraph 14 has been received by the CONTRACTING PARTIES, that the contracting party having recourse to this Section has made all reasonable efforts to reach an agreement and that the interests of other contracting parties are adequately safeguarded.\*

The contracting party having recourse to this Section shall thereupon be released from its obligations under the relevant provisions of the other Articles of this Agreement to the extent necessary to permit it to apply the measure.

19. If a proposed measure of the type described in paragraph 13 of this Article concerns an industry the establishment of which has in the initial period been facilitated by incidental protection afforded by restrictions imposed by the contracting party concerned for balance of payments purposes under the relevant provisions of this Agreement, that contracting party may resort to the provisions and procedures of this Section; *Provided that* it shall not apply the proposed measure without the concurrence\* of the CONTRACTING PARTIES.\*

20. Nothing in the preceding paragraphs of this Section shall authorize any deviation from the provisions of Articles I, II and XIII of this Agreement. The provisos to paragraph 10 of this Article shall also be applicable to any restriction under this Section.

21. At any time while a measure is being applied under paragraph 17 of this Article any contracting party substantially affected by it may suspend the application to the trade of the contracting party having recourse to this Section of such substantially equivalent concessions or other obligations under this Agreement the suspension of which the CONTRACTING PARTIES do not disapprove.\* *Provided that* sixty days' notice of such suspension is given to the CONTRACTING PARTIES not later than six months after the measure has been introduced or changed substantially to the detriment of the contracting party affected. Any such contracting party shall afford adequate opportunity for consultation in accordance with the provisions of Article XXII of this Agreement.

#### Section D

22. A contracting party coming within the scope of sub-paragraph 4 (b) of this Article desiring, in the interest of the development of its economy, to introduce a measure of the type described in paragraph 13 of this Article in respect of the establishment of a particular industry\* may apply to the CONTRACTING PARTIES for approval of such measure. The CONTRACTING PARTIES shall promptly consult with such contracting party and shall, in making their decision, be guided by the considerations set out in paragraph 16. If the CONTRACTING PARTIES concur\* in the proposed measure the contracting party concerned shall be released from its obligations under the relevant provisions of the other Articles of this Agreement to the extent necessary to permit it to apply the measure. If the proposed measure affects a product which is the subject of a concession included in the appropriate Schedule annexed to this Agreement, the provisions of paragraph 18 shall apply.\*

23. Any measure applied under this Section shall comply with the provisions of paragraph 20 of this Article.

#### Article XIX: Emergency Action on Imports of Particular Products

1. (a) If, as a result of unforeseen developments and of the effect of the obligations incurred by a contracting party under this Agreement, including tariff concessions, any product is being imported into the territory of that contracting party in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers in that territory of like or directly competitive products, the contracting party shall be free, in respect of such product, and to the extent and for such time as may be necessary to prevent or remedy such injury, to suspend the

obligation in whole or in part or to withdraw or modify the concession.

(b) If any product, which is the subject of a concession with respect to a preference, is being imported into the territory of a contracting party in the circumstances set forth in subparagraph (a) of this paragraph, so as to cause or threaten serious injury to domestic producers of like or directly competitive products in the territory of a contracting party which receives or received such preference, the importing contracting party shall be free, if that other contracting party so requests, to suspend the relevant obligation in whole or in part or to withdraw or modify the concession in respect of the product, to the extent and for such time as may be necessary to prevent or remedy such injury.

2. Before any contracting party shall take action pursuant to the provisions of paragraph 1 of this Article, it shall give notice in writing to the CONTRACTING PARTIES as far in advance as may be practicable and shall afford the CONTRACTING PARTIES and those contracting parties having a substantial interest as exporters of the product concerned an opportunity to consult with it in respect of the proposed action. When such notice is given in relation to a concession with respect to a preference, the notice shall name the contracting party which has requested the action. In critical circumstances, where delay would cause damage which it would be difficult to repair, action under paragraph 1 of this Article may be taken provisionally without prior consultation, on the condition that consultation shall be effected immediately after taking such action.

3. (a) If agreement among the interested contracting parties with respect to the action is not reached, the contracting party which proposes to take or continue the action shall, nevertheless, be free to do so, and if such action is taken or continued, the affected contracting parties shall then be free, not later than ninety days after such action is taken, to suspend, upon the expiration of thirty days from the day on which written notice of such suspension is received by the CONTRACTING PARTIES, the application to the trade of the contracting party taking such action, or, in the case envisaged in paragraph 1 (b) of this Article, to the trade of the contracting party requesting such suspension, of such substantially equivalent concessions or other obligations under this Agreement the suspension of which the CONTRACTING PARTIES do not disapprove.

(b) Notwithstanding the provisions of sub-paragraph (a) of this paragraph, where action is taken under paragraph 2 of this Article without prior consultation and causes or threatens serious injury in the territory of a contracting party to the domestic producers of products affected by the action, that contracting party shall, where delay would cause damage difficult to repair, be free to suspend, upon the taking of the action and throughout the period of consultation, such concessions or other obligations as may be necessary to prevent or remedy the injury.

#### *Article XX: General Exceptions*

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:

- (a) necessary to protect public morals;
- (b) necessary to protect human, animal or plant life or health;
- (c) relating to the importations or exportations of gold or silver;
- (d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the

protection of patents, trade marks and copyrights, and the prevention of deceptive practices;

- (e) relating to the products of prison labour;
- (f) imposed for the protection of national treasures of artistic, historic or archaeological value;
- (g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption;
- (h) undertaken in pursuance of obligations under any intergovernmental commodity agreement which conforms to criteria submitted to the CONTRACTING PARTIES and not disapproved by them or which is itself so submitted and not so disapproved;\*
- (i) involving restrictions on exports of domestic materials necessary to ensure essential quantities of such materials to a domestic processing industry during periods when the domestic price of such materials is held below the world price as part of a governmental stabilization plan; *Provided* that such restrictions shall not operate to increase the exports of or the protection afforded to such domestic industry, and shall not depart from the provisions of this Agreement relating to non-discrimination;
- (j) essential to the acquisition or distribution of products in general or local short supply; *Provided* that any such measures shall be consistent with the principle that all contracting parties are entitled to an equitable share of the international supply of such products, and that any such measures, which are inconsistent with the other provisions of the Agreement shall be discontinued as soon as the conditions giving rise to them have ceased to exist. The CONTRACTING PARTIES shall review the need for this sub-paragraph not later than 30 June 1960.

#### *Article XXI: Security Exceptions*

Nothing in this Agreement shall be construed

- (a) to require any contracting party to furnish any information the disclosure of which it considers contrary to its essential security interests; or
- (b) to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests
  - (i) relating to fissionable materials or the materials from which they are derived;
  - (ii) relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment;
  - (iii) taken in time of war or other emergency in international relations; or
- (c) to prevent any contracting party from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.
  - 1. Each contracting party shall accord sympathetic consideration to, and shall afford adequate opportunity for consultation regarding, such representations as may be made by another contracting party with respect to any matter affecting the operation of this Agreement.

#### *Article XXII: Consultation*

2. The CONTRACTING PARTIES may, at the request of a contracting party, consult with any contracting party or parties in respect of any matter for which it has not been possible to find a satisfactory solution through consultation under paragraph 1.

*Article XXIII: Nullification or Impairment*

1. 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 the 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.

2. If no satisfactory adjustment is effected between the contracting parties concerned within a reasonable time, or if the difficulty is of the type described in paragraph 1 (c) of this Article, the matter may be referred to the CONTRACTING PARTIES. The CONTRACTING PARTIES shall promptly investigate any matter so referred to them and shall make appropriate recommendations to the contracting parties which they consider to be concerned, or give a ruling on the matter, as appropriate. The CONTRACTING PARTIES may consult with contracting parties, with the Economic and Social Council of the United Nations and with any appropriate inter-governmental organization in cases where they consider such consultation necessary. If the CONTRACTING PARTIES consider that the circumstances are serious enough to justify such action, they may authorize a contracting party or parties to suspend the application to any other contracting party or parties of such concessions or other obligations under this Agreement as they determine to be appropriate in the circumstances. If the application to any contracting party of any concession or other obligation is in fact suspended, that contracting party shall then be free, not later than sixty days after such action is taken, to give written notice to the Executive Secretary<sup>1</sup> to the CONTRACTING PARTIES of its intention to withdraw from this Agreement and such withdrawal shall take effect upon the sixtieth day following the day on which such notice is received by him.

### PART III

*Article XXIV: Territorial Application - Frontier Traffic - Customs Unions and Free-trade Areas*

1. The provisions of this Agreement shall apply to the metropolitan customs territories of the contracting parties and to any other customs territories in respect of which this Agreement has been accepted under Article XXVI or is being applied under Article XXXIII or pursuant to the Protocol of Provisional Application. Each such customs territory shall, exclusively for the purposes of the territorial application of this Agreement, be treated as though it were a contracting party. *Provided*

<sup>1</sup> By the Decision of 23 March 1965, the CONTRACTING PARTIES changed the title of the head of the GATT secretariat from "Executive Secretary" to "Director-General".

that the provisions of this paragraph shall not be construed to create any rights or obligations as between two or more customs territories in respect of which this Agreement has been accepted under Article XXVI or is being applied under Article XXXIII or pursuant to the Protocol of Provisional Application by a single contracting party.

2. For the purposes of this Agreement a customs territory shall be understood to mean any territory with respect to which separate tariffs or other regulations of commerce are maintained for a substantial part of the trade of such territory with other territories.

3. The provisions of this Agreement shall not be construed to prevent:

- (a) Advantages accorded by any contracting party to adjacent countries in order to facilitate frontier traffic;
- (b) Advantages accorded to the trade with the Free Territory of Trieste by countries contiguous to that territory, provided that such advantages are not in conflict with the Treaties of Peace arising out of the Second World War.

4. The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements. They also recognize that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories.

5. Accordingly, the provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area; *Provided* that:

- (a) with respect to a customs union, or an interim agreement leading to a formation of a customs union, the duties and other regulations of commerce imposed at the institution of any such union or interim agreement in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union or the adoption of such interim agreement, as the case may be;
  - (b) with respect to a free-trade area, or an interim agreement leading to the formation of a free-trade area, the duties and other regulations of commerce maintained in each of the constituent territories and applicable at the formation of such free-trade area or the adoption of such interim agreement to the trade of contracting parties not included in such area or not parties to such agreement shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent territories prior to the formation of the free-trade area, or interim agreement as the case may be; and
  - (c) any interim agreement referred to in sub-paragraphs (a) and (b) shall include a plan and schedule for the formation of such a customs union or of such a free-trade area within a reasonable length of time.
6. If, in fulfilling the requirements of sub-paragraph 5 (a), a contracting party proposes to increase any rate of duty inconsistently with the provisions of Article II, the procedure set forth in Article XXXIII shall apply. In providing for compensatory adjustment, due account shall be taken of the compensation already afforded by the reduction brought about in the corresponding duty of the other constituents of the union.

7. (a) Any contracting party deciding to enter into a customs union or free-trade area, or an interim agreement leading to the formation of such a union or area, shall promptly notify the CONTRACTING PARTIES and shall make available to them such information regarding the proposed union or area as will enable them to make such reports and recommendations to contracting parties as they may deem appropriate.

(b) If, after having studied the plan and schedule included in an interim agreement referred to in paragraph 5 in consultation with the parties to that agreement and taking due account of the information made available in accordance with the provisions of sub-paragraph (a), the CONTRACTING PARTIES find that such agreement is not likely to result in the formation of a customs union or of a free-trade area within the period contemplated by the parties to the agreement or that such period is not a reasonable one, the CONTRACTING PARTIES shall make recommendations to the parties to the agreement. The parties shall not maintain or put into force, as the case may be, such agreement if they are not prepared to modify it in accordance with these recommendations.

(c) Any substantial change in the plan or schedule referred to in paragraph 5 (c) shall be communicated to the CONTRACTING PARTIES, which may request the contracting parties concerned to consult with them if the change seems likely to jeopardize or delay unduly the formation of the customs union or of the free-trade area.

8. For the purposes of this Agreement:

(a) A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that

(i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and,

(ii) subject to the provisions of paragraph 9, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union;

(b) A free-trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories.

9. The preferences referred to in paragraph 2 of Article I shall not be affected by the formation of a customs union or of a free-trade area but may be eliminated or adjusted by means of negotiations with contracting parties affected.\* This procedure of negotiations with affected contracting parties shall, in particular, apply to the elimination of preferences required to conform with the provisions of paragraph 8 (a)(i) and paragraph 8 (b).

10. The CONTRACTING PARTIES may by a two-thirds majority approve proposals which do not fully comply with the requirements of paragraphs 5 to 9 inclusive, provided that such proposals lead to the formation of a customs union or a free-trade area in the sense of this Article.

11. Taking into account the exceptional circumstances arising out of the establishment of India and Pakistan as independent States and recognizing the fact that they have long constituted an economic unit, the contracting parties agree that the provisions of this Agreement shall not prevent

the two countries from entering into special arrangements with respect to the trade between them, pending the establishment of their mutual trade relations on a definitive basis.\*

12. Each contracting party shall take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments and authorities within its territories.

*Article XXV: Joint Action by the Contracting Parties*

1. Representatives of the contracting parties shall meet from time to time for the purpose of giving effect to those provisions of this Agreement which involve joint action and, generally, with a view to facilitating the operation and furthering the objectives of this Agreement. Wherever reference is made in this Agreement to the contracting parties acting jointly they are designated as the CONTRACTING PARTIES.

2. The Secretary-General of the United Nations is requested to convene the first meeting of the CONTRACTING PARTIES, which shall take place not later than March 1, 1948.

3. Each contracting party shall be entitled to have one vote at all meetings of the CONTRACTING PARTIES.

4. Except as otherwise provided for in this Agreement, decisions of the CONTRACTING PARTIES shall be taken by a majority of the votes cast.

5. In exceptional circumstances not elsewhere provided for in this Agreement, the CONTRACTING PARTIES may waive an obligation imposed upon a contracting party by this Agreement: *Provided* that any such decision shall be approved by a two-thirds majority of the votes cast and that such majority shall comprise more than half of the contracting parties. The CONTRACTING PARTIES may also by such a vote

- (i) define certain categories of exceptional circumstances to which other voting requirements shall apply for the waiver of obligations, and
- (ii) prescribe such criteria as may be necessary for the application of this paragraph.<sup>1</sup>

*Article XXVI: Acceptance, Entry into Force and Registration*

1. The date of this Agreement shall be 30 October 1947.

2. This Agreement shall be open for acceptance by any contracting party which, on 1 March 1955, was a contracting party or was negotiating with a view to accession to this Agreement.

3. This Agreement, done in a single English original and a single French original, both texts authentic, shall be deposited with the Secretary-General of the United Nations, who shall furnish certified copies thereof to all interested governments.

4. Each government accepting this Agreement shall deposit an instrument of acceptance with the Executive Secretary<sup>1</sup> to the CONTRACTING PARTIES, who will inform all interested governments of the date of deposit of each instrument of acceptance and of the day on which this Agreement enters into force under paragraph 6 of this Article.

<sup>1</sup> The authentic text erroneously reads "sub-paragraph".

5. (a) Each government accepting this Agreement does so in respect of its metropolitan territory and of the other territories for which it has international responsibility, except such separate customs territories as it shall notify to the Executive Secretary<sup>1</sup> to the CONTRACTING PARTIES at the time of its own acceptance.

(b) Any government, which has so notified the Executive Secretary<sup>1</sup> under the exceptions in sub-paragraph (a) of this paragraph, may at any time give notice to the Executive Secretary<sup>1</sup> that its acceptance shall be effective in respect of any separate customs territory or territories so excepted and such notice shall take effect on the thirtieth day following the day on which it is received by the Executive Secretary.<sup>1</sup>

(c) If any of the customs territories, in respect of which a contracting party has accepted this Agreement, possesses or acquires full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement, such territory shall, upon sponsorship through a declaration by the responsible contracting party establishing the above-mentioned fact, be deemed to be a contracting party.

6. This Agreement shall enter into force, as among the governments which have accepted it, on the thirtieth day following the day on which instruments of acceptance have been deposited with Executive Secretary<sup>1</sup> to the CONTRACTING PARTIES on behalf of governments named in Annex H, the territories of which account for 85 per centum of the total external trade of the territories of such governments, computed in accordance with the applicable column of percentages set forth therein. The instrument of acceptance of each other government shall take effect on the thirtieth day following the day on which such instrument has been deposited.

7. The United Nations is authorized to effect registration of this Agreement as soon as it enters into force.

#### *Article XXVII: Withholding or Withdrawal of Concessions*

Any contracting party shall at any time be free to withhold or to withdraw in whole or in part any concession, provided for in the appropriate Schedule annexed to this Agreement, in respect of which such contracting party determines that it was initially negotiated with a government which has not become, or has ceased to be, a contracting party. A contracting party taking such action shall notify the CONTRACTING PARTIES and, upon request, consult with contracting parties which have a substantial interest in the product concerned.

#### *Article XXVIII\*: Modification of Schedules*

1. On the first day of each three-year period, the first period beginning on 1 January 1958 (or on the first day of any other period\* that may be specified by the CONTRACTING PARTIES by two-thirds of the votes cast) a contracting party (hereafter in this Article referred to as the "applicant contracting party") may, by negotiation and agreement with any contracting party with which such concession was initially negotiated and with any other contracting party determined by the CONTRACTING PARTIES to have a principal supplying interest\* (which two preceding categories of CONTRACTING PARTIES, together with the applicant contracting party, are in this Article hereinafter referred to as the "contracting parties primarily concerned"), and subject to consultation with any other contracting party determined by the CONTRACTING PARTIES to have a substantial interest\* in such concession, modify or withdraw a concession\* included in the appropriate schedule annexed to this Agreement.

<sup>1</sup> By the Decision of 23 March 1965, the CONTRACTING PARTIES changed the title of the head of the GATT secretariat from "Executive Secretary" to "Director-General".

2. In such negotiations and agreement, which may include provision for compensatory adjustment with respect to other products, the contracting parties concerned shall endeavour to maintain a general level of reciprocal and mutually advantageous concessions not less favourable to trade than that provided for in this Agreement prior to such negotiations.

3. (a) If agreement between the contracting parties primarily concerned cannot be reached before 1 January 1958 or before the expiration of a period envisaged in paragraph 1 of this Article, the contracting party which proposes to modify or withdraw the concession shall, nevertheless, be free to do so and if such action is taken any contracting party with which such concession was initially negotiated, any contracting party determined under paragraph 1 to have a principal supplying interest and any contracting party determined under paragraph 1 to have a substantial interest shall then be free not later than six months after such action is taken, to withdraw, upon the expiration of thirty days from the day on which written notice of such withdrawal is received by the CONTRACTING PARTIES, substantially equivalent concessions initially negotiated with the applicant contracting party.

(b) If agreement between the contracting parties primarily concerned is reached but any other contracting party determined under paragraph 1 of this Article to have a substantial interest is not satisfied, such other contracting party shall be free, not later than six months after action under such agreement is taken, to withdraw, upon the expiration of thirty days from the day on which written notice of such withdrawal is received by the CONTRACTING PARTIES, substantially equivalent concessions initially negotiated with the applicant contracting party.

4. The CONTRACTING PARTIES may, at any time, in special circumstances, authorize\* a contracting party to enter into negotiations for modification or withdrawal of a concession included in the appropriate Schedule annexed to this Agreement subject to the following procedures and conditions:

(a) Such negotiations\* and any related consultations shall be conducted in accordance with the provisions of paragraph 1 and 2 of this Article.

(b) If agreement between the contracting parties primarily concerned is reached in the negotiations, the provisions of paragraph 3 (b) of this Article shall apply.

(c) If agreement between the contracting parties primarily concerned is not reached within a period of sixty days\* after negotiations have been authorized, or within such longer period as the CONTRACTING PARTIES may have prescribed, the applicant contracting party may refer the matter to the CONTRACTING PARTIES.

(d) Upon such reference, the CONTRACTING PARTIES shall promptly examine the matter and submit their views to the contracting parties primarily concerned with the aim of achieving a settlement. If a settlement is reached, the provisions of paragraph 3 (b) shall apply as if agreement between the contracting parties primarily concerned had been reached. If no settlement is reached between the contracting parties primarily concerned, the applicant contracting party shall be free to modify or withdraw the concession, unless the CONTRACTING PARTIES determine that the applicant contracting party has unreasonably failed to offer adequate compensation.\* If such action is taken, any contracting party with which the concession was initially negotiated, any contracting party determined under paragraph 4 (a) to have a principal supplying interest and any contracting party determined under paragraph 4 (a) to have a substantial interest, shall be free, not later than six months after such action is taken, to modify or withdraw, upon the expiration of thirty days from the day on which written notice of such withdrawal is received by the CONTRACTING PARTIES, substantially equivalent concessions initially negotiated with applicant

contracting party.

5. Before 1 January 1958 and before the end of any period envisaged in paragraph 1 a contracting party may elect by notifying the CONTRACTING PARTIES to reserve the right, for the duration of the next period, to modify the appropriate Schedule in accordance with the procedures of paragraph 1 to 3. If a contracting party so elects, other contracting parties shall have the right, during the same period, to modify or withdraw, in accordance with the same procedures, concessions initially negotiated with that contracting party.

*Article XXVIII bis: Tariff Negotiations*

1. The contracting parties recognize that customs duties often constitute serious obstacles to trade; thus negotiations on a reciprocal and mutually advantageous basis, directed to the substantial reduction of the general level of tariffs and other charges on imports and exports and in particular to the reduction of such high tariffs as discourage the importation even of minimum quantities, and conducted with due regard to the objectives of this Agreement and the varying needs of individual contracting parties, are of great importance to the expansion of international trade. The CONTRACTING PARTIES may therefore sponsor such negotiations from time to time.

2. (a) Negotiations under this Article may be carried out on a selective product-by-product basis or by the application of such multilateral procedures as may be accepted by the contracting parties concerned. Such negotiations may be directed towards the reduction of duties, the binding of duties at then existing levels or undertakings that individual duties or the average duties on specified categories of products shall not exceed specified levels. The binding against increase of low duties or of duty-free treatment shall, in principle, be recognized as a concession equivalent in value to the reduction of high duties.

(b) The contracting parties recognize that in general the success of multilateral negotiations would depend on the participation of all contracting parties which conduct a substantial proportion of their external trade with one another.

3. Negotiations shall be conducted on a basis which affords adequate opportunity to take into account:

- (a) the needs of individual contracting parties and individual industries;
- (b) the needs of less-developed countries for a more flexible use of tariff protection to assist their economic development and the special needs of these countries to maintain tariffs for revenue purposes; and
- (c) all other relevant circumstances, including the fiscal,\* developmental, strategic and other needs of the contracting parties concerned.

*Article XXIX: The Relation of this Agreement to the Havana Charter*

1. The contracting parties undertake to observe to the fullest extent of their executive authority the general principles of Chapters I to VI inclusive and of Chapter IX of the Havana Charter pending their acceptance of it in accordance with their constitutional procedures.\*

2. Part II of this Agreement shall be suspended on the day on which the Havana Charter enters into force.

3. If by September 30, 1949, the Havana Charter has not entered into force, the contracting parties shall meet before December 31, 1949, to agree whether this Agreement shall be amended,

supplemented or maintained.

4. If at any time the Havana Charter should cease to be in force, the CONTRACTING PARTIES shall meet as soon as practicable thereafter to agree whether this Agreement shall be supplemented, amended or maintained. Pending such agreement, Part II of this Agreement shall again enter into force; *Provided* that the provisions of Part II other than Article XXIII shall be replaced, *mutatis mutandis*, in the form in which they then appeared in the Havana Charter; and *Provided* further that no contracting party shall be bound by any provisions which did not bind it at the time when the Havana Charter ceased to be in force.

5. If any contracting party has not accepted the Havana Charter by the date upon which it enters into force, the CONTRACTING PARTIES shall confer to agree whether, and if so in what way, this Agreement in so far as it affects relations between such contracting party and other contracting parties, shall be supplemented or amended. Pending such agreement the provisions of Part II of this Agreement shall, notwithstanding the provisions of paragraph 2 of this Article, continue to apply as between such contracting party and other contracting parties.

6. Contracting parties which are Members of the International Trade Organization shall not invoke the provisions of this Agreement so as to prevent the operation of any provision of the Havana Charter. The application of the principle underlying this paragraph to any contracting party which is not a Member of the International Trade Organization shall be the subject of an agreement pursuant to paragraph 5 of this Article.

*Article XXX: Amendments*

1. Except where provision for modification is made elsewhere in this Agreement, amendments to the provisions of Part I of this Agreement or the provisions of Article XXIX or of this Article shall become effective upon acceptance by all the contracting parties, and other amendments to this Agreement shall become effective, in respect of those contracting parties which accept them, upon acceptance by two-thirds of the contracting parties and thereafter for each other contracting party upon acceptance by it.

2. Any contracting party accepting an amendment to this Agreement shall deposit an instrument of acceptance with the Secretary-General of the United Nations within such period as the CONTRACTING PARTIES may specify. The CONTRACTING PARTIES may decide that any amendment made effective under this Article is of such a nature that any contracting party which has not accepted it within a period specified by the CONTRACTING PARTIES shall be free to withdraw from this Agreement, or to remain a contracting party with the consent of the CONTRACTING PARTIES.

*Article XXXI: Withdrawal*

Without prejudice to the provisions of paragraph 12 of Article XVIII, of Article XXIII or of paragraph 2 of Article XXX, any contracting party may withdraw from this Agreement, or may separately withdraw on behalf of any of the separate customs territories for which it has international responsibility and which at the time possesses full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement. The withdrawal shall take effect upon the expiration of six months from the day on which written notice of withdrawal is received by the Secretary-General of the United Nations.

*Article XXXII: Contracting Parties*

1. The contracting parties to this Agreement shall be understood to mean those governments which are applying the provisions of this Agreement under Articles XXVI or XXXIII or pursuant to the Protocol of Provisional Application.

2. At any time after the entry into force of this Agreement pursuant to paragraph 6 of Article XXVI, those contracting parties which have accepted this Agreement pursuant to paragraph 4 of Article XXVI may decide that any contracting party which has not so accepted it shall cease to be a contracting party.

*Article XXXIII: Accession*

A government not party to this Agreement, or a government acting on behalf of a separate customs territory possessing full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement, may accede to this Agreement, on its own behalf or on behalf of that territory, on terms to be agreed between such government and the CONTRACTING PARTIES. Decisions of the CONTRACTING PARTIES under this paragraph shall be taken by a two-thirds majority.

*Article XXXIV: Annexes*

The annexes to this Agreement are hereby made an integral part of this Agreement.

*Article XXXV: Non-application of the Agreement between Particular Contracting Parties*

1. This Agreement, or alternatively Article II of this Agreement, shall not apply as between any contracting party and any other contracting party if:
  - (a) the two contracting parties have not entered into tariff negotiations with each other, and
  - (b) either of the contracting parties, at the time either becomes a contracting party, does not consent to such application.
2. The CONTRACTING PARTIES may review the operation of this Article in particular cases at the request of any contracting party and make appropriate recommendations.

**PART IV\*: TRADE AND DEVELOPMENT**

*Article XXXVI: Principles and Objectives*

- 1.\* The contracting parties,
  - (a) recalling that the basic objectives of this Agreement include the raising of standards of living and the progressive development of the economies of all contracting parties, and considering that the attainment of these objectives is particularly urgent for less-developed contracting parties;
  - (b) considering that export earnings of the less-developed contracting parties can play a vital part in their economic development and that the extent of this contribution depends on the prices paid by the less-developed contracting parties for essential imports, the volume of their exports, and the prices received for these exports;
  - (c) noting, that there is a wide gap between standards of living in less-developed countries and in other countries;
  - (d) recognizing that individual and joint action is essential to further the development of the

economies of less-developed contracting parties and to bring about a rapid advance in the standards of living in these countries;

- (e) recognizing that international trade as a means of achieving economic and social advancement should be governed by such rules and procedures and measures in conformity with such rules and procedures as are consistent with the objectives set forth in this Article;
- (f) noting that the CONTRACTING PARTIES may enable less-developed contracting parties to use special measures to promote their trade and development; agree as follows.
  2. There is need for a rapid and sustained expansion of the export earnings of the less-developed contracting parties.
  3. There is need for positive efforts designed to ensure that less-developed contracting parties secure a share in the growth in international trade commensurate with the needs of their economic development.
  4. Given the continued dependence of many less-developed contracting parties on the exportation of a limited range of primary products,\* there is need to provide in the largest possible measure more favourable and acceptable conditions of access to world markets for these products, and wherever appropriate to devise measures designed to stabilize and improve conditions of world and markets in these products, including in particular measures designed to attain stable, equitable and remunerative prices, thus permitting an expansion of world trade and demand and a dynamic and steady growth of the real export earnings of these countries so as to provide them with expanding resources for their economic development.
  5. The rapid expansion of the economies of the less-developed contracting parties will be facilitated by a diversification\* of the structure of their economies and the avoidance of an excessive dependence on the export of primary products. There is, therefore, need for increased access in the largest possible measure to markets under favourable conditions for processed and manufactured products currently or potentially of particular export interest to less-developed contracting parties.
  6. Because of the chronic deficiency in the export proceeds and other foreign exchange earnings of less-developed contracting parties, there are important inter-relationships between trade and financial assistance to development. There is, therefore, need for close and continuing collaboration between the CONTRACTING PARTIES and the international lending agencies so that they can contribute most effectively to alleviating the burdens these less-developed contracting parties assume in the interest of their economic development.
  7. There is need for appropriate collaboration between the CONTRACTING PARTIES, other intergovernmental bodies and the organs and agencies of the United Nations system, whose activities relate to the trade and economic development of less-developed countries.
  8. The developed contracting parties do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed contracting parties.\*
  9. The adoption of measures to give effect to these principles and objectives shall be a matter of conscious and purposeful effort on the part of the contracting parties both individually and jointly.

*Article XXXVII: Commitments*

1. The developed contracting parties shall to the fullest extent possible \_ that is, except when compelling reasons, which may include legal reasons, make it impossible \_ give effect to the following provisions:
  - (a) accord high priority to the reduction and elimination of barriers to products currently or potentially of particular export interest to less-developed contracting parties, including customs duties and other restrictions which differentiate unreasonably between such products in their primary and in their processed forms;\*
    - (b) refrain from introducing, or increasing the incidence of, customs duties or non-tariff import barriers on products currently or potentially of particular export interest to less-developed contracting parties; and
    - (c) (i) refrain from imposing new fiscal measures, and
    - (ii) in any adjustments of fiscal policy accord high priority to the reduction and elimination of fiscal measures,
  - which would hamper, or which hamper, significantly the growth of consumption of primary products, in raw or processed form, wholly or mainly produced in the territories of less-developed contracting parties, and which are applied specifically to those products.
2. (a) Whenever it is considered that effect is not being given to any of the provisions of sub-paragraph (a), (b) or (c) of paragraph 1, the matter shall be reported to the CONTRACTING PARTIES either by the contracting party not so giving effect to the relevant provisions or by any other interested contracting party.
  - (b) (i) The CONTRACTING PARTIES shall, if requested so to do by any interested contracting party, and without prejudice to any bilateral consultations that may be undertaken, consult with the contracting party concerned and all interested contracting parties with respect to the matter with a view to reaching solutions satisfactory to all contracting parties concerned in order to further the objectives set forth in Article XXXVI. In the course of these consultations, the reasons given in cases where effect was not being given to the provisions of sub-paragraph (a), (b) or (c) of paragraph 1 shall be examined.
  - (ii) As the implementation of the provisions of sub-paragraph (a), (b) or (c) of paragraph 1 by individual contracting parties may in some cases be more readily achieved where action is taken jointly with other developed contracting parties, such consultation might, where appropriate, be directed towards this end.
  - (iii) The consultations by the CONTRACTING PARTIES might also, in appropriate cases, be directed towards agreement on joint action designed to further the objectives of this Agreement as envisaged in paragraph 1 of Article XXV.
3. The developed contracting parties shall:
  - (a) make every effort, in cases where a government directly or indirectly determines the resale price of products wholly or mainly produced in the territories of less-developed contracting parties, to maintain trade margins at equitable levels;
  - (b) give active consideration to the adoption of other measures\* designed to provide greater

scope for the development of imports from less-developed contracting parties and collaborate in appropriate international action to this end;

- (c) have special regard to the trade interests of less-developed contracting parties when considering the application of other measures permitted under this Agreement to meet particular problems and explore all possibilities of constructive remedies before applying such measures where they would affect essential interests of those contracting parties.
4. Less-developed contracting parties agree to take appropriate action in implementation of the provisions of Part IV for the benefit of the trade of other less-developed contracting parties, in so far as such action is consistent with their individual present and future development, financial and trade needs taking into account past trade developments as well as the trade interests of less-developed contracting parties as a whole.
5. In the implementation of the commitments set forth in paragraph 1 to 4 each contracting party shall afford to any other interested contracting party or contracting parties full and prompt opportunity for consultations under the normal procedures of this Agreement with respect to any matter or difficulty which may arise.

*Article XXXVIII: Joint Action*

1. The contracting parties shall collaborate jointly, with the framework of this Agreement and elsewhere, as appropriate, to further the objectives set forth in Article XXXVI.
2. In particular, the CONTRACTING PARTIES shall:
  - (a) where appropriate, take action, including action through international arrangements, to provide improved and acceptable conditions of access to world markets for primary products of particular interest to less-developed contracting parties and to devise measures designed to stabilize and improve conditions of world markets in these products including measures designed to attain stable, equitable and remunerative prices for exports of such products;
  - (b) seek appropriate collaboration in matters of trade and development policy with the United Nations and its organs and agencies, including any institutions that may be created on the basis of recommendations by the United Nations Conference on Trade and Development;
  - (c) collaborate in analysing the development plans and policies of individual less-developed contracting parties and in examining trade and aid relationships with a view to devising concrete measures to promote the development of export potential and to facilitate access to export markets for the products of the industries thus developed and, in this connection, seek appropriate collaboration with governments and international organizations, and in particular with organizations having competence in relation to financial assistance for economic development, in systematic studies of trade and aid relationships in individual less-developed contracting parties aimed at obtaining a clear analysis of export potential, market prospects and any further action that may be required;
  - (d) keep under continuous review the development of world trade with special reference to the rate of growth of the trade of less-developed contracting parties and make such recommendations to contracting parties as may, in the circumstances, be deemed appropriate;
  - (e) collaborate in seeking feasible methods to expand trade for the purpose of economic development, through international harmonization and adjustment of national policies and

regulations, through technical and commercial standards affecting production, transportation and marketing, and through export promotion by the establishment of facilities for the increased flow of trade information and the development of market research; and

- (f) establish such institutional arrangements as may be necessary to further the objectives set forth in Article XXXVI and to give effect to the provision of this Part.

**ANNEX A: List of Territories referred to in Paragraph 2 (a) of Article I**

United Kingdom of Great Britain and Northern Ireland  
 Dependent territories of the United Kingdom of Great Britain and Northern Ireland  
 Canada  
 Commonwealth of Australia  
 Dependent territories of the Commonwealth of Australia  
 New Zealand  
 Dependent territories of New Zealand  
 Union of South Africa including South West Africa  
 Ireland  
 India (as on April 10, 1947)  
 Newfoundland  
 Southern Rhodesia  
 Burma  
 Ceylon

Certain of the territories listed above have two or more preferential rates in force for certain products. Any such territory may, by agreement with the other contracting parties which are principal suppliers of such products at the most-favoured-nation rate, substitute for such preferential rates a single preferential rate which shall not on the whole be less favourable to suppliers at the most-favoured-nation rate than the preferences in force prior to such substitution.

The imposition of an equivalent margin of tariff preference to replace a margin of preference in an internal tax existing on April 10, 1947 exclusively between two or more of the territories listed in this Annex or to replace the preferential quantitative arrangements described in the following paragraph, shall not be deemed to constitute an increase in a margin of tariff preference.

The preferential arrangements referred to in paragraph 5 (b) of Article XIV are those existing in the United Kingdom on 10 April 1947, under contractual agreements with the Governments of Canada, Australia and New Zealand, in respect of chilled and frozen beef and veal, frozen mutton and lamb, chilled and frozen pork and bacon. It is the intention, without prejudice to any action taken under sub-paragraph (b) of Article XX, that these arrangements shall be eliminated or replaced by tariff preferences, and that negotiations to this end shall take place as soon as practicable among the countries substantially concerned or involved.

The film hire tax in force in New Zealand on 10 April 1947, shall, for the purposes of this Agreement, be treated as a customs duty under Article I. The renters' film quota in force in New Zealand on April 10, 1947, shall, for the purposes of this Agreement, be treated as a screen quota under Article IV.

The Dominions of India and Pakistan have not been mentioned separately in the above list since they had not come into existence as such on the base date of April 10, 1947.

**ANNEX B: List of Territories of the French Union referred to in Paragraph 2 (b) of Article I**

France  
 French Equatorial Africa (Treaty Basin of the Congo<sup>2</sup> and other territories)

<sup>1</sup> The authentic text erroneously reads "part I (b)".

<sup>2</sup> For imports into Metropolitan France and Territories of the French Union.

French West Africa  
 Cameroons under French Trusteeship<sup>1</sup>  
 French Somali Coast and Dependencies  
 French Establishments in Oceania  
 French Establishments in the Condominium of the New Hebrides<sup>1</sup>  
 Indo-China  
 Madagascar and Dependencies  
 Morocco (French zone)<sup>1</sup>  
 New Caledonia and Dependencies  
 Saint-Pierre and Miquelon  
 Togo under French Trusteeship<sup>1</sup>  
 Tunisia

**ANNEX C: List of Territories referred to in Paragraph 2 (b) of Article I as respects the Customs Union of Belgium, Luxembourg and the Netherlands**

The Economic Union of Belgium and Luxembourg  
 Belgian Congo  
 Ruanda Urundi  
 Netherlands  
 New Guinea  
 Surinam  
 Netherlands Antilles  
 Republic of Indonesia

For imports into the territories constituting the Customs Union only.

**ANNEX D: List of Territories referred to in Paragraph 2 (b) of Article I as respects the United States of America**

United States of America (customs territory)  
 Dependent territories of the United States of America  
 Republic of the Philippines

The imposition of an equivalent margin of tariff preference to replace a margin of preference in an internal tax existing on 10 April, 1947, exclusively between two or more of the territories listed in this Annex shall not be deemed to constitute an increase in a margin of tariff preference.

**ANNEX E: List of Territories covered by Preferential Arrangements between Chile and Neighbouring Countries referred to in Paragraph 2 (d) of Article I**

Preferences in force exclusively between Chile on the one hand, and

1. Argentina
  2. Bolivia
  3. Peru
- on the other hand.

**ANNEX F: List of Territories covered by Preferential Arrangements**

<sup>1</sup> For imports into Metropolitan France and Territories of the French Union.

**between Lebanon and Syria and Neighbouring Countries referred to in Paragraph 2 (d) of Article I**

Preferences in force exclusively between the Lebano-Syrian Customs Union, on the one hand, and

1. Palestine
  2. Transjordan
- on the other hand.

**ANNEX G: Dates establishing Maximum Margins of Preference referred to in Paragraph 4<sup>1</sup> of Article I**

Australia	October 15, 1946
Canada	July 1, 1939
France	January 1, 1939
Lebano-Syrian Customs Union	November 30, 1938
Union of South Africa	July 1, 1938
Southern Rhodesia	May 1, 1941

**ANNEX H: Percentage Shares of Total External Trade to be used for the Purpose of Making the Determination referred to in Article XXVI**

(based on the average of 1949-1953)

If, prior to the accession of the Government of Japan to the General Agreement, the present Agreement has been accepted by contracting parties the external trade of which under Column I accounts for the percentage of such trade specified in paragraph 6 of Article XXVI, column I shall be applicable for the purposes of that paragraph. If the present Agreement has not been so accepted prior to the accession of the Government of Japan, column II shall be applicable for the purposes of that paragraph.

	<i>Column I</i>	<i>Column II</i>
	(Contracting parties on 1 March 1955)	(Contracting parties on 1 March 1955 and Japan)
Australia	3.1	3.0
Austria	0.9	0.8
Belgium-Luxembourg	4.3	4.2
Brazil	2.5	2.4
Burma	0.3	0.3
Canada	6.7	6.5
Ceylon	0.5	0.5
Chile	0.6	0.6
Cuba	1.1	1.1
Czechoslovakia	1.4	1.4
Denmark	1.4	1.4
Dominican Republic	0.1	0.1

<sup>1</sup> The authentic text erroneously reads "Paragraph 3".

Finland	1.0
France	8.5
Germany, Federal Republic of	5.3
Greece	0.4
Haiti	0.1
India	2.4
Indonesia	1.3
Italy	2.9
Netherlands, Kingdom of the	4.7
New Zealand	1.0
Nicaragua	0.1
Norway	1.1
Pakistan	0.9
Peru	0.4
Rhodesia and Nyasaland	0.6
Sweden	2.5
Turkey	0.6
Union of South Africa	1.8
United Kingdom	20.3
United States of America	20.6
Uruguay	0.4
Japan	—
	100.0
	100.0

*Note:* These percentages have been computed taking into account the trade of all territories in respect of which the General Agreement on Tariffs and Trade is applied.

### ANNEX I: Notes and Supplementary Provisions

#### Ad Article I

##### Paragraph 1

The obligations incorporated in paragraph 1 of Article I by reference to paragraphs 2 and 4 of Article III and those incorporated in paragraph 2 (b) of Article II by reference to Article VI shall be considered as falling within Part II for the purposes of the Protocol of Provisional Application.

The cross-references, in the paragraph immediately above and in paragraph 1 of Article I, to paragraphs 2 and 4 of Article III shall only apply after Article III has been modified by the entry into force of the amendment provided for in the Protocol Modifying Part II and Article XXVI of the General Agreement on Tariffs and Trade, dated September 14, 1948.<sup>1</sup>

##### Paragraph 4

The term "margin of preference" means the absolute difference between the most-favoured-nation rate of duty and the preferential rate of duty for the like product, and not the proportionate relation between those rates. As examples:

- (1) If the most-favoured-nation rate were 36 per cent *ad valorem* and the preferential rate were 24 per cent *ad valorem*, the margin of preference would be 12 per cent *ad valorem*, and not one-third of the most-favoured-nation rate;
- (2) If the most-favoured-nation rate were 36 per cent *ad valorem* and the preferential rate were expressed as two-thirds of the most-favoured-nation rate, the margin of preference would be 12 per cent *ad valorem*;
- (3) If the most-favoured-nation rate were 2 francs per kilogramme and the preferential rate were 1.50 francs per kilogramme, the margin of preference would be 0.50 franc per kilogramme.

The following kinds of customs action, taken in accordance with established uniform procedures, would not be contrary to a general binding of margins of preference:

- (i) The re-application to an imported product of a tariff classification or rate of duty, properly applicable to such product, in cases in which the application of such classification or rate to such product was temporarily suspended or inoperative on April 10, 1947; and
- (ii) The classification of a particular product under a tariff item other than that under which importations of that product were classified on April 10, 1947, in cases in which the tariff law clearly contemplates that such product may be classified under more than one tariff item.

#### Ad Article II

##### Paragraph 2 (a)

The cross-reference, in paragraph 2 (a) of Article II, to paragraph 2 of Article III shall only apply after Article III has been modified by the entry into force of the amendment provided for in the Protocol Modifying Part II and Article XXVI of the General Agreement on Tariffs and Trade, dated September 14, 1948.<sup>1</sup>

##### Paragraph 2 (b)

See the note relating to paragraph 1 of Article I.

##### Paragraph 4

Except where otherwise specifically agreed between the contracting parties which initially negotiated the concession, the provisions of this paragraph will be applied in the light of the provisions of Article 31 of the Havana Charter.

#### Ad Article III

Any internal tax or other internal charge, or any law, regulation or requirement of the kind referred to in paragraph 1 which applies to an imported product and to the like domestic product and is collected or enforced in the case of the imported product at the time or point of importation, is nevertheless to be regarded as an internal tax or other internal charge, or a law, regulation or requirement of the kind referred to in paragraph 1, and is accordingly subject to the provisions of Article III.

<sup>1</sup> This Protocol entered into force on 14 December 1948.

<sup>1</sup> This Protocol entered into force on 14 December 1948.

*Paragraph 1*

The application of paragraph 1 to internal taxes imposed by local governments and authorities with the territory of a contracting party is subject to the provisions of the final paragraph of Article XXIV. The term "reasonable measures" in the last-mentioned paragraph would not require, for example, the repeal of existing national legislation authorizing local governments to impose internal taxes which, although technically inconsistent with the letter of Article III, are not in fact inconsistent with its spirit, if such repeal would result in a serious financial hardship for the local governments or authorities concerned. With regard to taxation by local governments or authorities which is inconsistent with both the letter and spirit of Article III, the term "reasonable measures" would permit a contracting party to eliminate the inconsistent taxation gradually over a transition period, if abrupt action would create serious administrative and financial difficulties.

*Paragraph 2*

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.

*Paragraph 5*

Regulations consistent with the provisions of the first sentence of paragraph 5 shall not be considered to be contrary to the provisions of the second sentence in any case in which all of the products subject to the regulations are produced domestically in substantial quantities. A regulation cannot be justified as being consistent with the provisions of the second sentence on the ground that the proportion or amount allocated to each of the products which are the subject of the regulation constitutes an equitable relationship between imported and domestic products.

*Ad Article V**Paragraph 5*

With regard to transportation charges, the principle laid down in paragraph 5 refers to like products being transported on the same route under like conditions.

*Ad Article VI**Paragraph 1*

1. Hidden dumping by associated houses (that is, the sale by an importer at a price below that corresponding to the price invoiced by an exporter with whom the importer is associated, and also below the price in the exporting country) constitutes a form of price dumping with respect to which the margin of dumping may be calculated on the basis of the price at which the goods are resold by the importer.

2. It is recognized that, in the case of imports from a country which has a complete or substantially complete monopoly of its trade and where all domestic prices are fixed by the State, special difficulties may exist in determining price comparability for the purposes of paragraph 1, and in such cases importing contracting parties may find it necessary to take into account the possibility that a strict comparison with domestic prices in such a country may not always be appropriate.

*Paragraphs 2 and 3*

1. As in many other cases in customs administration, a contracting party may require reasonable security (bond or cash deposit) for the payment of anti-dumping or countervailing duty pending final determination of the facts in any case of suspected dumping or subsidization.

2. Multiple currency practices can in certain circumstances constitute a subsidy to exports which may be met by countervailing duties under paragraph 3 or can constitute a form of dumping by means of a partial depreciation of a country's currency which may be met by action under paragraph 2. By "multiple currency practices" is meant practices by governments or sanctioned by governments.

*Paragraph 6 (b)*

Waivers under the provisions of this sub-paragraph shall be granted only on application by the contracting party proposing to levy an anti-dumping or countervailing duty, as the case may be.

*Ad Article VII**Paragraph 1*

The expression "or other charges" is not to be regarded as including internal taxes or equivalent charges imposed on or in connection with imported products.

*Paragraph 2*

1. It would be in conformity with Article VII to presume that "actual value" may be represented by the invoice price, plus any non-included charges for legitimate costs which are proper elements of "actual value" and plus any abnormal discount or other reduction from the ordinary competitive price.

2. It would be in conformity with Article VII, paragraph 2 (b), for a contracting party to construe the phrase "in the ordinary course of trade ... under fully competitive conditions", as excluding any transaction wherein the buyer and seller are not independent of each other and price is not the sole consideration.

3. The standard of "fully competitive conditions" permits a contracting party to exclude from consideration prices involving special discounts limited to exclusive agents.

4. The wording of sub-paragraphs (a) and (b) permits a contracting party to determine the value for customs purposes uniformly either (1) on the basis of a particular exporter's prices of the imported merchandise, or (2) on the basis of the general price level of like merchandise.

*Ad Article VIII*

1. While Article VIII does not cover the use of multiple rates of exchange as such, paragraphs 1 and 4 condemn the use of exchange taxes or fees as a device for implementing multiple currency practices; if, however, a contracting party is using multiple currency exchange fees for balance of payments reasons with the approval of the International Monetary Fund, the provisions of paragraph 9 (a) of Article XV fully safeguard its position.

2. It would be consistent with paragraph 1 if, on the importation of products from the territory of a contracting party into the territory of another contracting party, the production of certificates of origin should only be required to the extent that is strictly indispensable.

*Ad Articles XI, XII, XIII, XIV and XVIII*

Throughout Articles XI, XII, XIII, XIV and XVIII, the terms "import restrictions" or "export restrictions" include restrictions made effective through state-trading operations.

*Ad Article XI*

*Paragraph 2 (c)*

The term "in any form" in this paragraph covers the same products when in an early stage of processing and still perishable, which compete directly with the fresh product and if freely imported would tend to make the restriction on the fresh product ineffective.

*Paragraph 2, last sub-paragraph*

The term "special factors" includes changes in relative productive efficiency as between domestic and foreign producers, or as between different foreign producers, but not changes artificially brought about by means not permitted under the Agreement.

*Ad Article XVII*

The CONTRACTING PARTIES shall make provision for the utmost secrecy in the conduct of any consultation under the provisions of this Article.

*Paragraph 3 (c)(i)*

Contracting parties applying restrictions shall endeavour to avoid causing serious prejudice to exports of a commodity on which the economy of a contracting party is largely dependent.

*Paragraph 4 (b)*

It is agreed that the date shall be within ninety days after the entry into force of the amendments of this Article effected by the Protocol Amending the Preamble and Parts II and III of this Agreement. However, should the CONTRACTING PARTIES find that conditions were not suitable for the application of the provisions of this sub-paragraph at the time envisaged, they may determine a later date; *Provided* that such date is not more than thirty days after such time as the obligations of Article VIII, Sections 2, 3 and 4, of the Articles of Agreement of the International Monetary Fund become applicable to contracting parties, members of the Fund, the combined foreign trade of which constitutes at least fifty per centum of the aggregate foreign trade of all contracting parties.

*Paragraph 4 (e)*

It is agreed that paragraph 4 (e) does not add any new criteria for the imposition or maintenance of quantitative restrictions for balance of payments reasons. It is solely intended to ensure that all external factors such as changes in the terms of trade, quantitative restrictions, excessive tariffs and subsidies, which may be contributing to the balance of payments difficulties of the contracting party applying restrictions, will be fully taken into account.

*Ad Article XIII*

*Paragraph 2 (d)*

No mention was made of "commercial considerations" as a rule for the allocation of quotas because it was considered that its application by governmental authorities might not always be practicable. Moreover, in cases where it is practicable, a contracting party could apply these

considerations in the process of seeking agreement, consistently with the general rule laid down in the opening sentence of paragraph 2.

*Paragraph 4*

See note relating to "special factors" in connection with the last sub-paragraph of paragraph 2 of Article XI.

*Ad Article XIV*

*Paragraph 1*

The provisions of this paragraph shall not be so construed as to preclude full consideration by the CONTRACTING PARTIES, in the consultations provided for in paragraph 4 of Article XII and in paragraph 12 of Article XVIII, of the nature, effects and reasons for discrimination in the field of import restrictions.

*Paragraph 2*

One of the situations contemplated in paragraph 2 is that of a contracting party holding balances acquired as a result of current transactions which it finds itself unable to use without a measure of discrimination.

*Ad Article XV*

*Paragraph 4*

The word "frustrate" is intended to indicate, for example, that infringements of the letter of any Article of this Agreement by exchange action shall not be regarded as a violation of that Article if, in practice, there is no appreciable departure from the intent of the Article. Thus, a contracting party which, as part of its exchange control operated in accordance with the Articles of Agreement of the International Monetary Fund, requires payment to be received for its exports in its own currency or in the currency of one or more members of the International Monetary Fund will not thereby be deemed to contravene Article XI or Article XIII. Another example would be that of a contracting party which specifies on an import licence the country from which the goods may be imported, for the purpose not of introducing any additional element of discrimination in its import licensing system but of enforcing permissible exchange controls.

*Ad Article XVI*

The exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy.

*Section B*

1. Nothing in Section B shall preclude the use by a contracting party of multiple rates of exchange in accordance with the Articles of Agreement of the International Monetary Fund.

2. For the purposes of Section B, a "primary product" is understood to be any product of farm, forest or fishery, or any mineral, in its natural form or which has undergone such processing as is customarily required to prepare it for marketing in substantial volume in international trade.

*Paragraph 3*

1. The fact that a contracting party has not exported the product in question during the previous representative period would not in itself preclude that contracting party from establishing its right to obtain a share of the trade in the product concerned.
2. A system for the stabilization of the domestic price or of the return to domestic producers of a primary product independently of the movements of export prices, which results at times in the sale of the product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market, shall be considered not to involve a subsidy on exports within the meaning of paragraph 3 if the CONTRACTING PARTIES determine that:
  - (a) the system has also resulted, or is so designed as to result, in the sale of the product for export at a price higher than the comparable price charged for the like product to buyers in the domestic market; and
  - (b) the system is so operated, or is designed so to operate, either because of the effective regulation of production or otherwise, as not to stimulate exports unduly or otherwise seriously to prejudice the interests of other contracting parties.

Notwithstanding such determination by the CONTRACTING PARTIES, operations under such a system shall be subject to the provisions of paragraph 3 where they are wholly or partly financed out of government funds in addition to the funds collected from producers in respect of the product concerned.

#### *Paragraph 4*

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The intention of paragraph 4 is that the contracting parties should seek before the end of 1957 to reach agreement to abolish all remaining subsidies as from 1 January 1958; or, failing this, to reach agreement to extend the application of the standstill until the earliest date thereafter by which they can expect to reach such agreement.

#### *Ad Article XVII*

#### *Paragraph 1*

The operations of Marketing Boards, which are established by contracting parties and are engaged in purchasing or selling, are subject to the provisions of sub-paragraphs (a) and (b).

The activities of Marketing Boards which are established by contracting parties and which do not purchase or sell but lay down regulations covering private trade are governed by the relevant Articles of this Agreement.

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

#### *Paragraph 1 (a)*

Governmental measures imposed to insure standards of quality and efficiency in the operation of external trade, or privileges granted for the exploitation of national natural resources but which do not empower the government to exercise control over the trading activities of the enterprise in question, do not constitute "exclusive or special privileges".

#### *Paragraph 1 (b)*

A country receiving a "tied loan" is free to take this loan into account as a "commercial consideration" when purchasing requirements abroad.

#### *Paragraph 2*

The term "goods" is limited to products as understood in commercial practice, and is not intended to include the purchase or sale of services.

#### *Paragraph 3*

Negotiations which contracting parties agree to conduct under this paragraph may be directed towards the reduction of duties and other charges on imports and exports or towards the conclusion of any other mutually satisfactory arrangement consistent with the provisions of this Agreement. (See paragraph 4 of Article II and the note to that paragraph.)

#### *Paragraph 4 (b)*

The term "import mark-up" in this paragraph shall represent the margin by which the price charged by the import monopoly for the imported product (exclusive of internal taxes within the purview of Article III, transportation, distribution, and other expenses incident to the purchase, sale or further processing, and a reasonable margin of profit) exceeds the landed cost.

#### *Ad Article XVIII*

The CONTRACTING PARTIES and the contracting parties concerned shall preserve the utmost secrecy in respect of matters arising under this Article.

#### *Paragraphs 1 and 4*

1. When they consider whether the economy of a contracting party "can only support low standards of living", the CONTRACTING PARTIES shall take into consideration the normal position of that economy and shall not base their determination on exceptional circumstances such as those which may result from the temporary existence of exceptionally favourable conditions for the staple export product or products of such contracting party.

2. The phrase "in the early stages of development" is not meant to apply only to contracting parties which have just started their economic development, but also to contracting parties the economies of which are undergoing a process of industrialization to correct an excessive dependence on primary production.

#### *Paragraphs 2, 3, 7, 13 and 22*

The reference to the establishment of particular industries shall apply not only to the establishment of a new industry, but also to the establishment of a new branch of production in an existing industry and to the substantial transformation of an existing industry, and to the substantial expansion of an existing industry supplying a relatively small proportion of the domestic demand. It shall also cover the reconstruction of an industry destroyed or substantially damaged as a result of hostilities or natural disasters.

#### *Paragraph 7 (b)*

A modification or withdrawal, pursuant to paragraph 7 (b), by a contracting party, other than the applicant contracting party, referred to in paragraph 7 (a), shall be made within six months of the

day on which the action is taken by the applicant contracting party, and shall become effective on the thirtieth day following the day on which such modification or withdrawal has been notified to the CONTRACTING PARTIES.

*Paragraph 11*

The second sentence in paragraph 11 shall not be interpreted to mean that a contracting party is required to relax or remove restrictions if such relaxation or removal would thereupon produce conditions justifying the intensification or institution, respectively, of restrictions under paragraph 9 of Article XVIII.

*Paragraph 12 (b)*

The date referred to in paragraph 12 (b) shall be the date determined by the CONTRACTING PARTIES in accordance with the provisions of paragraph 4 (b) of Article XII of this Agreement.

*Paragraphs 13 and 14*

It is recognized that, before deciding on the introduction of a measure and notifying the CONTRACTING PARTIES in accordance with paragraph 14, a contracting party may need a reasonable period of time to assess the competitive position of the industry concerned.

*Paragraphs 15 and 16*

It is understood that the CONTRACTING PARTIES shall invite a contracting party proposing to apply a measure under Section C to consult with them pursuant to paragraph 16 if they are requested to do so by a contracting party the trade of which would be appreciably affected by the measure in question.

*Paragraphs 16, 18, 19 and 22*

1. It is understood that the CONTRACTING PARTIES may concur in a proposed measure subject to specific conditions or limitations. If the measure as applied does not conform to the terms of the concurrence it will to that extent be deemed a measure in which the CONTRACTING PARTIES have not concurred. In cases in which the CONTRACTING PARTIES have concurred in a measure for a specified period, the contracting party concerned, if it finds that the maintenance of the measure for a further period of time is required to achieve the objective for which the measure was originally taken, may apply to the CONTRACTING PARTIES for an extension of that period in accordance with the provisions and procedures of Section C or D, as the case may be.

2. It is expected that the CONTRACTING PARTIES will, as a rule, refrain from concurring in a measure which is likely to cause serious prejudice to exports of a commodity on which the economy of a contracting party is largely dependent.

*Paragraph 18 and 22*

The phrase "that the interests of other contracting parties are adequately safeguarded" is meant to provide latitude sufficient to permit consideration in each case of the most appropriate method of safeguarding those interests. The appropriate method may, for instance, take the form of an additional concession to be applied by the contracting party having recourse to Section C or D during such time as the deviation from the other Articles of the Agreement would remain in force or of the temporary suspension by any other contracting party referred to in paragraph 18 of a concession substantially equivalent to the impairment due to the introduction of the measure in question. Such contracting party would have the right to safeguard its interests through such a

temporary suspension of a concession; *Provided* that this right will not be exercised when, in the case of a measure imposed by a contracting party coming within the scope of paragraph 4 (a), the CONTRACTING PARTIES have determined that the extent of the compensatory concession proposed was adequate.

*Paragraph 19*

The provisions of paragraph 19 are intended to cover the cases where an industry has been in existence beyond the "reasonable period of time" referred to in the note to paragraphs 13 and 14, and should not be so construed as to deprive a contracting party coming within the scope of paragraph 4 (a) of Article XVIII, of its right to resort to the other provisions of Section C, including paragraph 17, with regard to a newly established industry even though it has benefited from incidental protection afforded by balance of payments import restrictions.

*Paragraph 21*

Any measure taken pursuant to the provisions of paragraph 21 shall be withdrawn forthwith if the action taken in accordance with paragraph 17 is withdrawn or if the CONTRACTING PARTIES concur in the measure proposed after the expiration of the ninety-day time limit specified in paragraph 17.

*Ad Article XX*

*Sub-paragraph (h)*

The exception provided for in this sub-paragraph extends to any commodity agreement which conforms to the principles approved by the Economic and Social Council in its resolution 30 (IV) of 28 March 1947.

*Ad Article XXIV*

*Paragraph 9*

It is understood that the provisions of Article I would require that, when a product which has been imported into the territory of a member of a customs union or free-trade area at a preferential rate of duty is re-exported to the territory of another member of such union or area, the latter member should collect a duty equal to the difference between the duty already paid and any higher duty that would be payable if the product were being imported directly into its territory.

*Paragraph 11*

Measures adopted by India and Pakistan in order to carry out definitive trade arrangements between them, once they have been agreed upon, might depart from particular provisions of this Agreement, but these measures would in general be consistent with the objectives of the Agreement.  
*Ad Article XXVII*

The CONTRACTING PARTIES and each contracting party concerned should arrange to conduct the negotiations and consultations with the greatest possible secrecy in order to avoid premature disclosure of details of prospective tariff changes. The CONTRACTING PARTIES shall be informed immediately of all changes in national tariffs resulting from recourse to this Article.

*Paragraph 1*

1. If the CONTRACTING PARTIES specify a period other than a three-year period, a contracting

party may act pursuant to paragraph 1 or paragraph 3 of Article XXVIII on the first day following the expiration of such other period and, unless the CONTRACTING PARTIES have again specified another period, subsequent periods will be three-year periods following the expiration of such specified period.

2. The provision that on 1 January 1958, and on other days determined pursuant to paragraph 1, a contracting party "may ... modify or withdraw a concession" means that on such day, and on the first day after the end of each period, the legal obligation of such contracting party under Article II is altered; it does not mean that the changes in its customs tariff should necessarily be made effective on that day. If a tariff change resulting from negotiations undertaken pursuant to this Article is delayed, the entry into force of any compensatory concessions may be similarly delayed.

3. Not earlier than six months, nor later than three months, prior to 1 January 1958, or to the termination date of any subsequent period, a contracting party wishing to modify or withdraw any concession embodied in the appropriate Schedule, should notify the CONTRACTING PARTIES to this effect. The CONTRACTING PARTIES shall then determine the contracting party or contracting parties with which the negotiations or consultations referred to in paragraph 1 shall take place. Any contracting party so determined shall participate in such negotiations or consultations with the applicant contracting party with the aim of reaching agreement before the end of the period. Any extension of the assured life of the Schedules shall relate to the Schedules as modified after such negotiations, in accordance with paragraphs 1, 2, and 3 of Article XXVIII. If the CONTRACTING PARTIES are arranging for multilateral tariff negotiations to take place within the period of six months before 1 January 1958, or before any other day determined pursuant to paragraph 1, they shall include in the arrangements for such negotiations suitable procedures for carrying out the negotiations referred to in this paragraph.

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4. The object of providing for the participation in the negotiation of any contracting party with a principle supplying interest, in addition to any contracting party with which the concession was originally negotiated, is to ensure that a contracting party with a larger share in the trade affected by the concession than a contracting party with which the concession was originally negotiated shall have an effective opportunity to protect the contractual right which it enjoys under this Agreement. On the other hand, it is not intended that the scope of the negotiations should be such as to make negotiations and agreement under Article XXVIII unduly difficult nor to create complications in the application of this Article in the future to concessions which result from negotiations thereunder. Accordingly, the CONTRACTING PARTIES should only determine that a contracting party has a principal supplying interest if that contracting party has had, over a reasonable period of time prior to the negotiations, a larger share in the market of the applicant contracting party than a contracting party with which the concession was initially negotiated or would, in the judgement of the CONTRACTING PARTIES, have had such a share in the absence of discriminatory quantitative restrictions maintained by the applicant contracting party. It would therefore not be appropriate for the CONTRACTING PARTIES to determine that more than one contracting party, or in those exceptional cases where there is near equality more than two contracting parties, had a principal supplying interest.

5. Notwithstanding the definition of a principal supplying interest in note 4 to paragraph 1, the CONTRACTING PARTIES may exceptionally determine that a contracting party has a principal supplying interest if the concession in question affects trade which constitutes a major part of the total exports of such contracting party.

6. It is not intended that provision for participation in the negotiations of any contracting party with a principal supplying interest, and for consultation with any contracting party having a substantial interest in the concession which the applicant contracting party is seeking to modify or withdraw, should have the effect that it should have to pay compensation or suffer retaliation greater than the withdrawal or modification sought, judged in the light of the conditions of trade at the time

of the proposed withdrawal or modification, making allowance for any discriminatory quantitative restrictions maintained by the applicant contracting party.

7. The expression "substantial interest" is not capable of a precise definition and accordingly may present difficulties for the CONTRACTING PARTIES. It is, however, intended to be construed to cover only those contracting parties which have, or in the absence of discriminatory quantitative restrictions affecting their exports could reasonably be expected to have, a significant share in the market of the contracting party seeking to modify or withdraw the concession.

*Paragraph 4*

1. Any request for authorization to enter into negotiations shall be accompanied by all relevant statistical and other data. A decision on such request shall be made within thirty days of its submission.

2. It is recognized that to permit certain contracting parties, depending in large measure on a relatively small number of primary commodities and relying on the tariff as an important aid for furthering diversification of their economies or as an important source of revenue, normally to negotiate for the modification or withdrawal of concessions only under paragraph 1 of Article XXVIII, might cause them at such time to make modifications or withdrawals which in the long run would prove unnecessary. To avoid such a situation the CONTRACTING PARTIES shall authorize any such contracting party, under paragraph 4, to enter into negotiations unless they consider this would result in, or contribute substantially towards, such an increase in tariff levels as to threaten the stability of the Schedules to this Agreement or lead to undue disturbance of international trade.

3. It is expected that negotiations authorized under paragraph 4 for modification or withdrawal of a single item, or a very small group of items, could normally be brought to a conclusion in sixty days. It is recognized, however, that such a period will be inadequate for cases involving negotiations for the modification or withdrawal of a larger number of items and in such cases, therefore, it would be appropriate for the CONTRACTING PARTIES to prescribe a longer period.

4. The determination referred to in paragraph 4 (d) shall be made by the CONTRACTING PARTIES within thirty days of the submission of the matter to them unless the applicant contracting party agrees to a longer period.

5. In determining under paragraph 4 (d) whether an applicant contracting party has unreasonably failed to offer adequate compensation, it is understood that the CONTRACTING PARTIES will take due account of the special position of a contracting party which has bound a high proportion of its tariffs at very low rates of duty and to this extent has less scope than other contracting parties to make compensatory adjustment.

*Ad Article XXVIII bis*

*Paragraph 3*

It is understood that the reference to fiscal needs would include the revenues aspect of duties and particularly duties imposed primarily for revenue purpose, or duties imposed on products which can be substituted for products subject to revenue duties to prevent the avoidance of such duties.

*Ad Article XXIX*

*Paragraph 1*

Chapters VII and VIII of the Havana Charter have been excluded from paragraph 1 because

they generally deal with the organization, functions and procedures of the International Trade Organization.

*Ad Part IV*

The words "developed contracting parties" and the words "less-developed contracting parties" as used in Part IV are to be understood to refer to developed and less-developed countries which are parties to the General Agreement on Tariffs and Trade.

*Ad Article XXXVII*

*Paragraph 1*

This Article is based upon the objectives set forth in Article I as it will be amended by Section A of paragraph 1 of the Protocol Amending Part I and Articles XXIX and XXX when that Protocol enters into force.<sup>1</sup>

*Paragraph 4*

The term "primary products" includes agricultural products, *vide* paragraph 2 of the note *ad* Article XVI, Section B.

*Paragraph 5*

A diversification programme would generally include the intensification of activities for the processing of primary products and the development of manufacturing industries, taking into account the situation of the particular contracting party and the world outlook for production and consumption of different commodities.

*Paragraph 8*

It is understood that the phrase "do not expect reciprocity" means, in accordance with the objectives set forth in this Article, that the less-developed contracting parties should not be expected, in the course of trade negotiations, to make contributions which are inconsistent with their individual development, financial and trade needs, taking into consideration past trade developments.

This paragraph would apply in the event of action under Section A of Article XVIII, Article XXVIII, Article XXVIII *bis* (Article XXIX after the amendment set forth in Section A of paragraph 1 of the Protocol Amending Part I and Articles XXIX and XXX shall have become effective), Article XXXIII, or any other procedure under this Agreement.

*Ad Article XXXVII*

*Paragraph 1 (a)*

This paragraph would apply in the event of negotiations for reduction or elimination of tariffs or other restrictive regulations of commerce under Articles XXVIII, XXVIII *bis* (XXIX after the amendment set forth in Section A of paragraph 1 of the Protocol Amending Part I and Articles XXIX and XXX shall have become effective), and Article XXXIII, as well as in connection with other action to effect such reduction or elimination which contracting parties may be able to undertake.

<sup>1</sup> This Protocol was abandoned on 1 January 1968.

*Paragraph 3 (b)*

The other measures referred to in this paragraph might include steps to promote domestic structural changes, to encourage the consumption of particular products, or to introduce measures of trade promotion.

### PROTOCOL OF PROVISIONAL APPLICATION OF THE GENERAL AGREEMENT ON TARIFFS AND TRADE

1. The Governments of the COMMONWEALTH OF AUSTRALIA, the KINGDOM OF BELGIUM (in respect of its metropolitan territory), CANADA, the FRENCH REPUBLIC (in respect of its metropolitan territory), the GRAND-DUCHY OF LUXEMBURG, the KINGDOM OF THE NETHERLANDS (in respect of its metropolitan territory), the UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND (in respect of its metropolitan territory), and the UNITED STATES OF AMERICA undertake, provided that this Protocol shall have been signed on behalf of all the foregoing Governments not later than 15 November 1947, to apply provisionally on and after 1 January 1948:

(a) Parts I and III of the General Agreement on Tariffs and Trade, and

(b) Part II of that Agreement to the fullest extent not inconsistent with existing legislation.

2. The foregoing Governments shall make effective such provisional application of the General Agreement, in respect of any of their territories other than their metropolitan territories, on or after 1 January 1948, upon the expiration of thirty days from the day on which notice of such application is received by the Secretary-General of the United Nations.

3. Any other government signatory to this Protocol shall make effective such provisional application of the General Agreement, on or after 1 January 1948, upon the expiration of thirty days from the day of signature of this Protocol on behalf of such Government.

4. This Protocol shall remain open for signature at the Headquarters of the United Nations (a) until 15 November 1947, on behalf of any government named in paragraph 1 of this Protocol which has not signed it on this day, and (b) until 30 June 1948, on behalf of any other Government signatory to the Final Act adopted at the conclusion of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment which has not signed it on this day.

5. Any government applying this Protocol shall be free to withdraw such application, and such withdrawal shall take effect upon the expiration of sixty days from the day on which written notice of such withdrawal is received by the Secretary-General of the United Nations.

6. The original of this Protocol shall be deposited with the Secretary-General of the United Nations, who will furnish certified copies thereof to all interested Governments.

In WITNESS WHEREOF the respective Representatives, after having communicated their full powers, found to be in good and due form, have signed the Protocol.

DONE at Geneva, in a single copy, in the English and the French languages, both texts authentic, this thirtieth day of October one thousand nine hundred and forty-seven.



## **General Agreement on Tariffs and Trade, 1994**

## GENERAL AGREEMENT ON TARIFFS AND TRADE 1994

1. The General Agreement on Tariffs and Trade 1994 ("GATT 1994") shall consist of:
  - (a) the provisions in the General Agreement on Tariffs and Trade, dated 30 October 1947, annexed to the Final Act Adopted at the Conclusion of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment (excluding the Protocol of Provisional Application), as rectified, amended or modified by the terms of legal instruments which have entered into force before the date of entry into force of the WTO Agreement;
  - (b) the provisions of the legal instruments set forth below that have entered into force under the GATT 1947 before the date of entry into force of the WTO Agreement:
    - (i) protocols and certifications relating to tariff concessions;
    - (ii) protocols of accession (excluding the provisions (a) concerning provisional application and withdrawal of provisional application and (b) providing that Part II of GATT 1947 shall be applied provisionally to the fullest extent not inconsistent with legislation existing on the date of the Protocol);
    - (iii) decisions on waivers granted under Article XXV of GATT 1947 and still in force on the date of entry into force of the WTO Agreement<sup>1</sup>;
    - (iv) other decisions of the CONTRACTING PARTIES to GATT 1947;
  - (c) the Understandings set forth below:
    - (i) Understanding on the Interpretation of Article II:1(b) of the General Agreement on Tariffs and Trade 1994;
    - (ii) Understanding on the Interpretation of Article XVII of the General Agreement on Tariffs and Trade 1994;
    - (iii) Understanding on Balance-of-Payments Provisions of the General Agreement on Tariffs and Trade 1994;
    - (iv) Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994;
    - (v) Understanding in Respect of Waivers of Obligations under the General Agreement on Tariffs and Trade 1994;
    - (vi) Understanding on the Interpretation of Article XXVIII of the General Agreement on Tariffs and Trade 1994; and
  - (d) the Marrakesh Protocol to GATT 1994.

<sup>1</sup>The waivers covered by this provision are listed in footnote 7 on pages 11 and 12 in Part II of document MTN/FA of 15 December 1993 and in MTN/FA/Corr.6 of 21 March 1994. The Ministerial Conference shall establish at its first session a revised list of waivers covered by this provision that adds any waivers granted under GATT 1947 after 15 December 1993 and before the date of entry into force of the WTO Agreement, and deletes the waivers which will have expired by that time.

## 2. Explanatory Notes

- (a) The references to "contracting party" in the provisions of GATT 1994 shall be deemed to read "Member". The references to "less-developed contracting party" and "developed contracting party" shall be deemed to read "developing country Member" and "developed country Member". The references to "Executive Secretary" shall be deemed to read "Director-General of the WTO".
- (b) The references to the CONTRACTING PARTIES acting jointly in Articles XV:1, XV:2, XV:8, XXXVIII and the Notes *Ad Article XII* and XXVIII; and in the provisions on special exchange agreements in Articles XV:2, XV:3, XV:6, XV:7 and XV:9 of GATT 1994 shall be deemed to be references to the WTO. The other functions that the provisions of GATT 1994 assign to the CONTRACTING PARTIES acting jointly shall be allocated by the Ministerial Conference.
  - (c) (i) The text of GATT 1994 shall be authentic in English, French and Spanish.
  - (ii) The text of GATT 1994 in the French language shall be subject to the rectifications of terms indicated in Annex A to document MTN.TNC/41.
  - (iii) The authentic text of GATT 1994 in the Spanish language shall be the text in Volume IV of the Basic Instruments and Selected Documents series, subject to the rectifications of terms indicated in Annex B to document MTN.TNC/41.
3. (a) The provisions of Part II of GATT 1994 shall not apply to measures taken by a Member under specific mandatory legislation, enacted by that Member before it became a contracting party to GATT 1947, that prohibits the use, sale or lease of foreign-built or foreign-reconstructed vessels in commercial applications between points in national waters or the waters of an exclusive economic zone. This exemption applies to: (a) the continuation or prompt renewal of a non-conforming provision of such legislation; and (b) the amendment to a non-conforming provision of such legislation to the extent that the amendment does not decrease the conformity of the provision with Part II of GATT 1947. This exemption is limited to measures taken under legislation described above that is notified and specified prior to the date of entry into force of the WTO Agreement. If such legislation is subsequently modified to decrease its conformity with Part II of GATT 1994, it will no longer qualify for coverage under this paragraph.
  - (b) The Ministerial Conference shall review this exemption not later than five years after the date of entry into force of the WTO Agreement and thereafter every two years for as long as the exemption is in force for the purpose of examining whether the conditions which created the need for the exemption still prevail.
  - (c) A Member whose measures are covered by this exemption shall annually submit a detailed statistical notification consisting of a five-year moving average of actual and expected deliveries of relevant vessels as well as additional information on the use, sale, lease or repair of relevant vessels covered by this exemption.
  - (d) A Member that considers that this exemption operates in such a manner as to justify a reciprocal and proportionate limitation on the use, sale, lease or repair of vessels constructed in the territory of the Member invoking the exemption shall be free to introduce such a limitation subject to prior notification to the Ministerial Conference.
  - (e) This exemption is without prejudice to solutions concerning specific aspects of the legislation covered by this exemption negotiated in sectoral agreements or in other fora.

**UNDERSTANDING ON THE INTERPRETATION OF ARTICLE II:1(b)  
OF THE GENERAL AGREEMENT ON TARIFFS AND TRADE 1994**

*Members* hereby agree as follows:

1. In order to ensure transparency of the legal rights and obligations deriving from paragraph 1(b) of Article II, the nature and level of any "other duties or charges" levied on bound tariff items, as referred to in that provision, shall be recorded in the Schedules of concessions annexed to GATT 1994 against the tariff item to which they apply. It is understood that such recording does not change the legal character of "other duties or charges".
2. The date as of which "other duties or charges" are bound, for the purposes of Article II, shall be 15 April 1994. "Other duties or charges" shall therefore be recorded in the Schedules at the levels applying on this date. At each subsequent renegotiation of a concession or negotiation of a new concession the applicable date for the tariff item in question shall become the date of the incorporation of the new concession in the appropriate Schedule. However, the date of the instrument by which a concession on any particular tariff item was first incorporated into GATT 1947 or GATT 1994 shall also continue to be recorded in column 6 of the Loose-Leaf Schedules.
3. "Other duties or charges" shall be recorded in respect of all tariff bindings.
4. Where a tariff item has previously been the subject of a concession, the level of "other duties or charges" recorded in the appropriate Schedule shall not be higher than the level obtaining at the time of the first incorporation of the concession in that Schedule. It will be open to any Member to challenge the existence of an "other duty or charge", on the ground that no such "other duty or charge" existed at the time of the original binding of the item in question, as well as the consistency of the recorded level of any "other duty or charge" with the previously bound level, for a period of three years after the date of entry into force of the WTO Agreement or three years after the date of deposit with the Director-General of the WTO of the instrument incorporating the Schedule in question into GATT 1994, if that is a later date.
5. The recording of "other duties or charges" in the Schedules is without prejudice to their consistency with rights and obligations under GATT 1994 other than those affected by paragraph 4. All Members retain the right to challenge, at any time, the consistency of any "other duty or charge" with such obligations.
6. For the purposes of this Understanding, the provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding shall apply.
7. "Other duties or charges" omitted from a Schedule at the time of deposit of the instrument incorporating the Schedule in question into GATT 1994 with, until the date of entry into force of the WTO Agreement, the Director-General to the CONTRACTING PARTIES to GATT 1947 or, thereafter, with the Director-General of the WTO, shall not subsequently be added to it and any "other duty or charge" recorded at a level lower than that prevailing on the applicable date shall not be restored to that level unless such additions or changes are made within six months of the date of deposit of the instrument.
8. The decision in paragraph 2 regarding the date applicable to each concession for the purposes of paragraph 1(b) of Article II of GATT 1994 supersedes the decision regarding the applicable date taken on 26 March 1980 (BISD 27S/24).

**UNDERSTANDING ON THE INTERPRETATION OF ARTICLE XVII  
OF THE GENERAL AGREEMENT ON TARIFFS AND TRADE 1994**

*Members*,

*Noting* that Article XVII provides for obligations on Members in respect of the activities of the state trading enterprises referred to in paragraph 1 of Article XVII, which are required to be consistent with the general principles of non-discriminatory treatment prescribed in GATT 1994 for governmental measures affecting imports or exports by private traders;

*Noting* further that Members are subject to their GATT 1994 obligations in respect of those governmental measures affecting state trading enterprises;

*Recognizing* that this Understanding is without prejudice to the substantive disciplines prescribed in Article XVII;

Hereby agree as follows:

1. In order to ensure the transparency of the activities of state trading enterprises, Members shall notify such enterprises to the Council for Trade in Goods, for review by the working party to be set up under paragraph 5, in accordance with the following working definition:

"Governmental and non-governmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports."

This notification requirement does not apply to imports of products for immediate or ultimate consumption in governmental use or in use by an enterprise as specified above and not otherwise for resale or use in the production of goods for sale.

2. Each Member shall conduct a review of its policy with regard to the submission of notifications on state trading enterprises to the Council for Trade in Goods, taking account of the provisions of this Understanding. In carrying out such a review, each Member should have regard to the need to ensure the maximum transparency possible in its notifications so as to permit a clear appreciation of the manner of operation of the enterprises notified and the effect of their operations on international trade.
3. Notifications shall be made in accordance with the questionnaire on state trading adopted on 24 May 1960 (BISD 9S/184-185), it being understood that Members shall notify the enterprises referred to in paragraph 1 whether or not imports or exports have in fact taken place.
4. Any Member which has reason to believe that another Member has not adequately met its notification obligation may raise the matter with the Member concerned. If the matter is not satisfactorily resolved it may make a counter-notification to the Council for Trade in Goods, for consideration by the working party set up under paragraph 5, simultaneously informing the Member concerned.
5. A working party shall be set up, on behalf of the Council for Trade in Goods, to review notifications and counter-notifications. In the light of this review and without prejudice to paragraph 4(c) of Article XVII, the Council for Trade in Goods may make recommendations

with regard to the adequacy of notifications and the need for further information. The working party shall also review, in the light of the notifications received, the adequacy of the above-mentioned questionnaire on state trading and the coverage of state trading enterprises notified under paragraph 1. It shall also develop an illustrative list showing the kinds of relationships between governments and enterprises, and the kinds of activities, engaged in by these enterprises, which may be relevant for the purposes of Article XVII. It is understood that the Secretariat will provide a general background paper for the working party on the operations of state trading enterprises as they relate to international trade. Membership of the working party shall be open to all Members indicating their wish to serve on it. It shall meet within a year of the date of entry into force of the WTO Agreement and thereafter at least once a year. It shall report annually to the Council for Trade in Goods.<sup>1</sup>

<sup>1</sup>The activities of this working party shall be coordinated with those of the working group provided for in Section III of the Ministerial Decision on Notification Procedures adopted on 15 April 1994.

## **UNDERSTANDING ON THE BALANCE-OF-PAYMENTS PROVISIONS OF THE GENERAL AGREEMENT ON TARIFFS AND TRADE 1994**

*Members,*

*Recognizing* the provisions of Articles XII and XVIII:B of GATT 1994 and of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes adopted on 28 November 1979 (BISD 26S/205-209, referred to in this Understanding as the "1979 Declaration") and in order to clarify such provisions<sup>1</sup>;

Hereby *agree* as follows:

### *Application of Measures*

1. Members confirm their commitment to announce publicly, as soon as possible, time-schedules for the removal of restrictive import measures taken for balance-of-payments purposes. It is understood that such time-schedules may be modified as appropriate to take into account changes in the balance-of-payments situation. Whenever a time-schedule is not publicly announced by a Member, that Member shall provide justification as to the reasons therefor.
2. Members confirm their commitment to give preference to those measures which have the least disruptive effect on trade. Such measures (referred to in this Understanding as "price-based measures") shall be understood to include import surcharges, import deposit requirements or other equivalent trade measures with an impact on the price of imported goods. It is understood that, notwithstanding the provisions of Article II, price-based measures taken for balance-of-payments purposes may be applied by a Member in excess of the duties inscribed in the Schedule of that Member. Furthermore, that Member shall indicate the amount by which the price-based measure exceeds the bound duty clearly and separately under the notification procedures of this Understanding.
3. Members shall seek to avoid the imposition of new quantitative restrictions for balance-of-payments purposes unless, because of a critical balance-of-payments situation, price-based measures cannot arrest a sharp deterioration in the external payments position. In those cases in which a Member applies quantitative restrictions, it shall provide justification as to the reasons why price-based measures are not an adequate instrument to deal with the balance-of-payments situation. A Member maintaining quantitative restrictions shall indicate in successive consultations the progress made in significantly reducing the incidence and restrictive effect of such measures. It is understood that not more than one type of restrictive import measure taken for balance-of-payments purposes may be applied on the same product.
4. Members confirm that restrictive import measures taken for balance-of-payments purposes may only be applied to control the general level of imports and may not exceed what is necessary to address the balance-of-payments situation. In order to minimize any incidental protective effects, a Member shall administer restrictions in a transparent manner. The authorities of the importing Member shall provide adequate justification as to the criteria used to determine which products are subject to restriction. As provided in paragraph 3 of Article XII

<sup>1</sup>Nothing in this Understanding is intended to modify the rights and obligations of Members under Articles XII or XVIII:B of GATT 1994. The provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding may be invoked with respect to any matters arising from the application of restrictive import measures taken for balance-of-payments purposes.

and paragraph 10 of Article XVIII, Members may, in the case of certain essential products, exclude or limit the application of surcharges applied across the board or other measures applied for balance-of-payments purposes. The term "essential products" shall be understood to mean products which meet basic consumption needs or which contribute to the Member's effort to improve its balance-of-payments situation, such as capital goods or inputs needed for production. In the administration of quantitative restrictions, a Member shall use discretionary licensing only when unavoidable and shall phase it out progressively. Appropriate justification shall be provided as to the criteria used to determine allowable import quantities or values.

#### *Procedures for Balance-of-Payments Consultations*

5. The Committee on Balance-of-Payments Restrictions (referred to in this Understanding as the "Committee") shall carry out consultations in order to review all restrictive import measures taken for balance-of-payments purposes. The membership of the Committee is open to all Members indicating their wish to serve on it. The Committee shall follow the procedures for consultations on balance-of-payments restrictions approved on 28 April 1970 (BISD 18S/48-53, referred to in this Understanding as "full consultation procedures"), subject to the provisions set out below.

6. A Member applying new restrictions or raising the general level of its existing restrictions by a substantial intensification of the measures shall enter into consultations with the Committee within four months of the adoption of such measures. The Member adopting such measures may request that a consultation be held under paragraph 4(a) of Article XII or paragraph 12(a) of Article XVIII as appropriate. If no such request has been made, the Chairman of the Committee shall invite the Member to hold such a consultation. Factors that may be examined in the consultation would include, *inter alia*, the introduction of new types of restrictive measures for balance-of-payments purposes, or an increase in the level or product coverage of restrictions.

7. All restrictions applied for balance-of-payments purposes shall be subject to periodic review in the Committee under paragraph 4(b) of Article XII or under paragraph 12(b) of Article XVIII, subject to the possibility of altering the periodicity of consultations in agreement with the consulting Member or pursuant to any specific review procedure that may be recommended by the General Council.

8. Consultations may be held under the simplified procedures approved on 19 December 1972 (BISD 20S/47-49, referred to in this Understanding as "simplified consultation procedures") in the case of least-developed country Members or in the case of developing country Members which are pursuing liberalization efforts in conformity with the schedule presented to the Committee in previous consultations. Simplified consultation procedures may also be used when the Trade Policy Review of a developing country Member is scheduled for the same calendar year as the date fixed for the consultations. In such cases the decision as to whether full consultation procedures should be used will be made on the basis of the factors enumerated in paragraph 8 of the 1979 Declaration. Except in the case of least-developed country Members, no more than two successive consultations may be held under simplified consultation procedures.

#### *Notification and Documentation*

9. A Member shall notify to the General Council the introduction of or any changes in the application of restrictive import measures taken for balance-of-payments purposes, as well as any modifications in time-schedules for the removal of such measures as announced under paragraph 1. Significant changes shall be notified to the General Council prior to or not later than 30 days after their announcement. On a yearly basis, each Member shall make available to the Secretariat a consolidated notification, including all changes in laws, regulations, policy

statements or public notices, for examination by Members. Notifications shall include full information, as far as possible, at the tariff-line level, on the type of measures applied, the criteria used for their administration, product coverage and trade flows affected.

10. At the request of any Member, notifications may be reviewed by the Committee. Such reviews would be limited to the clarification of specific issues raised by a notification or examination of whether a consultation under paragraph 4(a) of Article XII or paragraph 12(a) of Article XVIII is required. Members which have reasons to believe that a restrictive import measure applied by another Member was taken for balance-of-payments purposes may bring the matter to the attention of the Committee. The Chairman of the Committee shall request information on the measure and make it available to all Members. Without prejudice to the right of any member of the Committee to seek appropriate clarifications in the course of consultations, questions may be submitted in advance for consideration by the consulting Member.

11. The consulting Member shall prepare a Basic Document for the consultations which, in addition to any other information considered to be relevant, should include: (a) an overview of the balance-of-payments situation and prospects, including a consideration of the internal and external factors having a bearing on the balance-of-payments situation and the domestic policy measures taken in order to restore equilibrium on a sound and lasting basis; (b) a full description of the restrictions applied for balance-of-payments purposes, their legal basis and steps taken to reduce incidental protective effects; (c) measures taken since the last consultation to liberalize import restrictions, in the light of the conclusions of the Committee; (d) a plan for the elimination and progressive relaxation of remaining restrictions. References may be made, when relevant, to the information provided in other notifications or reports made to the WTO. Under simplified consultation procedures, the consulting Member shall submit a written statement containing essential information on the elements covered by the Basic Document.

12. The Secretariat shall, with a view to facilitating the consultations in the Committee, prepare a factual background paper dealing with the different aspects of the plan for consultations. In the case of developing country Members, the Secretariat document shall include relevant background and analytical material on the incidence of the external trading environment on the balance-of-payments situation and prospects of the consulting Member. The technical assistance services of the Secretariat shall, at the request of a developing country Member, assist in preparing the documentation for the consultations.

#### *Conclusions of Balance-of-Payments Consultations*

13. The Committee shall report on its consultations to the General Council. When full consultation procedures have been used, the report should indicate the Committee's conclusions on the different elements of the plan for consultations, as well as the facts and reasons on which they are based. The Committee shall endeavour to include in its conclusions proposals for recommendations aimed at promoting the implementation of Articles XII and XVIII:B, the 1979 Declaration and this Understanding. In those cases in which a time-schedule has been presented for the removal of restrictive measures taken for balance-of-payments purposes, the General Council may recommend that, in adhering to such a time-schedule, a Member shall be deemed to be in compliance with its GATT 1994 obligations. Whenever the General Council has made specific recommendations, the rights and obligations of Members shall be assessed in the light of such recommendations. In the absence of specific proposals for recommendations by the General Council, the Committee's conclusions should record the different views expressed in the Committee. When simplified consultation procedures have

been used, the report shall include a summary of the main elements discussed in the Committee and a decision on whether full consultation procedures are required.

**UNDERSTANDING ON THE INTERPRETATION OF ARTICLE XXIV OF THE GENERAL AGREEMENT ON TARIFFS AND TRADE 1994**

*Members,*

*Having regard to the provisions of Article XXIV of GATT 1994;*

*Recognizing that customs unions and free trade areas have greatly increased in number and importance since the establishment of GATT 1947 and today cover a significant proportion of world trade;*

*Recognizing the contribution to the expansion of world trade that may be made by closer integration between the economies of the parties to such agreements;*

*Recognizing also that such contribution is increased if the elimination between the constituent territories of duties and other restrictive regulations of commerce extends to all trade, and diminished if any major sector of trade is excluded;*

*Reaffirming that the purpose of such agreements should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other Members with such territories; and that in their formation or enlargement the parties to them should to the greatest possible extent avoid creating adverse effects on the trade of other Members;*

*Convinced also of the need to reinforce the effectiveness of the role of the Council for Trade in Goods in reviewing agreements notified under Article XXIV, by clarifying the criteria and procedures for the assessment of new or enlarged agreements, and improving the transparency of all Article XXIV agreements;*

*Recognizing the need for a common understanding of the obligations of Members under paragraph 12 of Article XXIV;*

Hereby agree as follows:

1. Customs unions, free-trade areas, and interim agreements leading to the formation of a customs union or free-trade area, to be consistent with Article XXIV, must satisfy, *inter alia*, the provisions of paragraphs 5, 6, 7 and 8 of that Article.

*Article XXIV:5*

2. The evaluation under paragraph 5(a) of Article XXIV of the general incidence of the duties and other regulations of commerce applicable before and after the formation of a customs union shall in respect of duties and charges be based upon an overall assessment of weighted average tariff rates and of customs duties collected. This assessment shall be based on import statistics for a previous representative period to be supplied by the customs union, on a tariff-line basis and in values and quantities, broken down by WTO country of origin. The Secretariat shall compute the weighted average tariff rates and customs duties collected in accordance with the methodology used in the assessment of tariff offers in the Uruguay Round of Multilateral Trade Negotiations. For this purpose, the duties and charges to be taken into consideration shall be the applied rates of duty. It is recognized that for the purpose of the overall assessment of the incidence of other regulations of commerce for which quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows affected may be required.

3. The "reasonable length of time" referred to in paragraph 5(c) of Article XXIV should exceed 10 years only in exceptional cases. In cases where Members parties to an interim agreement believe that 10 years would be insufficient they shall provide a full explanation to the Council for Trade in Goods of the need for a longer period.

*Article XXIV:6*

4. Paragraph 6 of Article XXIV establishes the procedure to be followed when a Member forming a customs union proposes to increase a bound rate of duty. In this regard Members reaffirm that the procedure set forth in Article XXVIII, as elaborated in the guidelines adopted on 10 November 1980 (BISD 27S/26-28) and in the Understanding on the Interpretation of Article XXVIII of GATT 1994, must be commenced before tariff concessions are modified or withdrawn upon the formation of a customs union or an interim agreement leading to the formation of a customs union.

5. These negotiations will be entered into in good faith with a view to achieving mutually satisfactory compensatory adjustment. In such negotiations, as required by paragraph 6 of Article XXIV, due account shall be taken of reductions of duties on the same tariff line made by other constituents of the customs union upon its formation. Should such reductions not be sufficient to provide the necessary compensatory adjustment, the customs union would offer compensation, which may take the form of reductions of duties on other tariff lines. Such an offer shall be taken into consideration by the Members having negotiating rights in the binding being modified or withdrawn. Should the compensatory adjustment remain unacceptable, negotiations should be continued. Where, despite such efforts, agreement in negotiations on compensatory adjustment under Article XXVIII as elaborated by the Understanding on the Interpretation of Article XXVIII of GATT 1994 cannot be reached within a reasonable period from the initiation of negotiations, the customs union shall, nevertheless, be free to modify or withdraw the concessions; affected Members shall then be free to withdraw substantially equivalent concessions in accordance with Article XXVIII.

6. GATT 1994 imposes no obligation on Members benefiting from a reduction of duties consequent upon the formation of a customs union, or an interim agreement leading to the formation of a customs union, to provide compensatory adjustment to its constituents.

*Review of Customs Unions and Free-Trade Areas*

7. All notifications made under paragraph 7(a) of Article XXIV shall be examined by a working party in the light of the relevant provisions of GATT 1994 and of paragraph 1 of this Understanding. The working party shall submit a report to the Council for Trade in Goods on its findings in this regard. The Council for Trade in Goods may make such recommendations to Members as it deems appropriate.

8. In regard to interim agreements, the working party may in its report make appropriate recommendations on the proposed time-frame and on measures required to complete the formation of the customs union or free-trade area. It may if necessary provide for further review of the agreement.

9. Members parties to an interim agreement shall notify substantial changes in the plan and schedule included in that agreement to the Council for Trade in Goods and, if so requested, the Council shall examine the changes.

10. Should an interim agreement notified under paragraph 7(a) of Article XXIV not include a plan and schedule, contrary to paragraph 5(c) of Article XXIV, the working party shall in

its report recommend such a plan and schedule. The parties shall not maintain or put into force, as the case may be, such agreement if they are not prepared to modify it in accordance with these recommendations. Provision shall be made for subsequent review of the implementation of the recommendations.

11. Customs unions and constituents of free-trade areas shall report periodically to the Council for Trade in Goods, as envisaged by the CONTRACTING PARTIES to GATT 1947 in their instruction to the GATT 1947 Council concerning reports on regional agreements (BISD 18S/38), on the operation of the relevant agreement. Any significant changes and/or developments in the agreements should be reported as they occur.

*Dispute Settlement*

12. The provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding may be invoked with respect to any matters arising from the application of those provisions of Article XXIV relating to customs unions, free-trade areas or interim agreements leading to the formation of a customs union or free-trade area.

*Article XXIV:12*

13. Each Member is fully responsible under GATT 1994 for the observance of all provisions of GATT 1994, and shall take such reasonable measures as may be available to it to ensure such observance by regional and local governments and authorities within its territory.

14. The provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding may be invoked in respect of measures affecting its observance taken by regional or local governments or authorities within the territory of a Member. When the Dispute Settlement Body has ruled that a provision of GATT 1994 has not been observed, the responsible Member shall take such reasonable measures as may be available to it to ensure its observance. The provisions relating to compensation and suspension of concessions or other obligations apply in cases where it has not been possible to secure such observance.

15. Each Member undertakes to accord sympathetic consideration to and afford adequate opportunity for consultation regarding any representations made by another Member concerning measures affecting the operation of GATT 1994 taken within the territory of the former.

**UNDERSTANDING IN RESPECT OF WAIVERS OF OBLIGATIONS  
UNDER THE GENERAL AGREEMENT ON TARIFFS AND TRADE 1994**

*Members hereby agree as follows:*

1. A request for a waiver or for an extension of an existing waiver shall describe the measures which the Member proposes to take, the specific policy objectives which the Member seeks to pursue and the reasons which prevent the Member from achieving its policy objectives by measures consistent with its obligations under GATT 1994.
2. Any waiver in effect on the date of entry into force of the WTO Agreement shall terminate, unless extended in accordance with the procedures above and those of Article IX of the WTO Agreement, on the date of its expiry or two years from the date of entry into force of the WTO Agreement, whichever is earlier.
3. Any Member considering that a benefit accruing to it under GATT 1994 is being nullified or impaired as a result of:
  - (a) the failure of the Member to whom a waiver was granted to observe the terms or conditions of the waiver, or
  - (b) the application of a measure consistent with the terms and conditions of the waiver
 may invoke the provisions of Article XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding.

**UNDERSTANDING ON THE INTERPRETATION OF ARTICLE XXVIII  
OF THE GENERAL AGREEMENT ON TARIFFS AND TRADE 1994**

*Members hereby agree as follows:*

1. For the purposes of modification or withdrawal of a concession, the Member which has the highest ratio of exports affected by the concession (i.e. exports of the product to the market of the Member modifying or withdrawing the concession) to its total exports shall be deemed to have a principal supplying interest if it does not already have an initial negotiating right or a principal supplying interest as provided for in paragraph 1 of Article XXVIII. It is however agreed that this paragraph will be reviewed by the Council for Trade in Goods five years from the date of entry into force of the WTO Agreement with a view to deciding whether this criterion has worked satisfactorily in securing a redistribution of negotiating rights in favour of small and medium-sized exporting Members. If this is not the case, consideration will be given to possible improvements, including, in the light of the availability of adequate data, the adoption of a criterion based on the ratio of exports affected by the concession to exports to all markets of the product in question.
2. Where a Member considers that it has a principal supplying interest in terms of paragraph 1, it should communicate its claim in writing, with supporting evidence, to the Member proposing to modify or withdraw a concession, and at the same time inform the Secretariat. Paragraph 4 of the "Procedures for Negotiations under Article XXVIII" adopted on 10 November 1980 (BISD 27S/26-28) shall apply in these cases.
3. In the determination of which Members have a principal supplying interest (whether as provided for in paragraph 1 above or in paragraph 1 of Article XXVIII) or substantial interest, only trade in the affected product which has taken place on an MFN basis shall be taken into consideration. However, trade in the affected product which has taken place under non-contractual preferences shall also be taken into account if the trade in question has ceased to benefit from such preferential treatment, thus becoming MFN trade, at the time of the negotiation for the modification or withdrawal of the concession, or will do so by the conclusion of that negotiation.
4. When a tariff concession is modified or withdrawn on a new product (i.e. a product for which three years' trade statistics are not available) the Member possessing initial negotiating rights on the tariff line where the product is or was formerly classified shall be deemed to have an initial negotiating right in the concession in question. The determination of principal supplying and substantial interests and the calculation of compensation shall take into account, *inter alia*, production capacity and investment in the affected product in the exporting Member and estimates of export growth, as well as forecasts of demand for the product in the importing Member. For the purposes of this paragraph, "new product" is understood to include a tariff item created by means of a breakout from an existing tariff line.
5. Where a Member considers that it has a principal supplying or a substantial interest in terms of paragraph 4, it should communicate its claim in writing, with supporting evidence, to the Member proposing to modify or withdraw a concession, and at the same time inform the Secretariat. Paragraph 4 of the above-mentioned "Procedures for Negotiations under Article XXVIII" shall apply in these cases.
6. When an unlimited tariff concession is replaced by a tariff rate quota, the amount of compensation provided should exceed the amount of the trade actually affected by the modification of the concession. The basis for the calculation of compensation should be the

amount by which future trade prospects exceed the level of the quota. It is understood that the calculation of future trade prospects should be based on the greater of:

- (a) the average annual trade in the most recent representative three-year period, increased by the average annual growth rate of imports in that same period, or by 10 per cent, whichever is the greater; or
- (b) trade in the most recent year increased by 10 per cent.

In no case shall a Member's liability for compensation exceed that which would be entailed by complete withdrawal of the concession.

7. Any Member having a principal supplying interest, whether as provided for in paragraph 1 above or in paragraph 1 of Article XXVIII, in a concession which is modified or withdrawn shall be accorded an initial negotiating right in the compensatory concessions, unless another form of compensation is agreed by the Members concerned.

## MARRAKESH PROTOCOL TO THE GENERAL AGREEMENT ON TARIFFS AND TRADE 1994

*Members,*

*Having* carried out negotiations within the framework of GATT 1947, pursuant to the Ministerial Declaration on the Uruguay Round,

Hereby *agree* as follows:

1. The schedule annexed to this Protocol relating to a Member shall become a Schedule to GATT 1994 relating to that Member on the day on which the WTO Agreement enters into force for that Member. Any schedule submitted in accordance with the Ministerial Decision on measures in favour of least-developed countries shall be deemed to be annexed to this Protocol.
2. The tariff reductions agreed upon by each Member shall be implemented in five equal rate reductions, except as may be otherwise specified in a Member's Schedule. The first such reduction shall be made effective on the date of entry into force of the WTO Agreement, each successive reduction shall be made effective on 1 January of each of the following years, and the final rate shall become effective no later than the date four years after the date of entry into force of the WTO Agreement, except as may be otherwise specified in that Member's Schedule. Unless otherwise specified in its Schedule, a Member that accepts the WTO Agreement after its entry into force shall, on the date that Agreement enters into force for it, make effective all rate reductions that have already taken place together with the reductions which it would under the preceding sentence have been obligated to make effective on 1 January of the year following, and shall make effective all remaining rate reductions on the schedule specified in the previous sentence. The reduced rate should in each stage be rounded off to the first decimal. For agricultural products, as defined in Article 2 of the Agreement on Agriculture, the staging of reductions shall be implemented as specified in the relevant parts of the schedules.
3. The implementation of the concessions and commitments contained in the schedules annexed to this Protocol shall, upon request, be subject to multilateral examination by the Members. This would be without prejudice to the rights and obligations of Members under Agreements in Annex 1A of the WTO Agreement.
4. After the schedule annexed to this Protocol relating to a Member has become a Schedule to GATT 1994 pursuant to the provisions of paragraph 1, such Member shall be free at any time to withhold or to withdraw in whole or in part the concession in such Schedule with respect to any product for which the principal supplier is any other Uruguay Round participant the schedule of which has not yet become a Schedule to GATT 1994. Such action can, however, only be taken after written notice of any such withholding or withdrawal of a concession has been given to the Council for Trade in Goods and after consultations have been held, upon request, with any Member, the relevant schedule relating to which has become a Schedule to GATT 1994 and which has a substantial interest in the product involved. Any concessions so withheld or withdrawn shall be applied on and after the day on which the schedule of the Member which has the principal supplying interest becomes a Schedule to GATT 1994.
5. (a) Without prejudice to the provisions of paragraph 2 of Article 4 of the Agreement on Agriculture, for the purpose of the reference in paragraphs 1:(b) and 1(c) of Article II of GATT 1994 to the date of that Agreement, the applicable date in respect of each product which is the subject of a concession provided for in a schedule of concessions annexed to this Protocol shall be the date of this Protocol.

- (b) For the purpose of the reference in paragraph 6(a) of Article II of GATT 1994 to the date of that Agreement, the applicable date in respect of a schedule of concessions annexed to this Protocol shall be the date of this Protocol.
6. In cases of modification or withdrawal of concessions relating to non-tariff measures as contained in Part III of the schedules, the provisions of Article XXVIII of GATT 1994 and the "Procedures for Negotiations under Article XXVIII" adopted on 10 November 1980 (BISD 27S/26-28) shall apply. This would be without prejudice to the rights and obligations of Members under GATT 1994.
7. In each case in which a schedule annexed to this Protocol results for any product in treatment less favourable than was provided for such product in the Schedules of GATT 1947 prior to the entry into force of the WTO Agreement, the Member to whom the schedule relates shall be deemed to have taken appropriate action as would have been otherwise necessary under the relevant provisions of Article XXVIII of GATT 1947 or 1994. The provisions of this paragraph shall apply only to Egypt, Peru, South Africa and Uruguay.
8. The Schedules annexed hereto are authentic in the English, French or Spanish language as specified in each Schedule.
9. The date of this Protocol is 15 April 1994.

[The agreed schedules of participants will be annexed to the Marrakesh Protocol in the treaty copy of the WTO Agreement.]

**Agreement on the Application of Sanitary and  
Phytosanitary Measures, 1994**

## AGREEMENT ON THE APPLICATION OF SANITARY AND PHYTOSANITARY MEASURES

*Members,*

*Recognizing* that no Member should be prevented from adopting or enforcing measures necessary to protect human, animal or plant life or health, subject to the requirement that these measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between Members where the same conditions prevail<sup>1</sup> or a disguised restriction on international trade;

*Desiring* to improve the human health, animal health and phytosanitary situation in all Members;

*Noting* that sanitary and phytosanitary measures are often applied on the basis of bilateral agreements or protocols;

*Desiring* the establishment of a multilateral framework of rules and disciplines to guide the development, adoption and enforcement of sanitary and phytosanitary measures in order to minimize their negative effects on trade;

*Recognizing* the important contribution that international standards, guidelines and recommendations can make in this regard;

*Desiring* to further the use of harmonized sanitary and phytosanitary measures between Members, on the basis of international standards, guidelines and recommendations developed by the relevant international organizations, including the Codex Alimentarius Commission, the International Office of Epizootics, and the relevant international and regional organizations operating within the framework of the International Plant Protection Convention, without requiring Members to change their appropriate level of protection of human, animal or plant life or health;

*Recognizing* that developing country Members may encounter special difficulties in complying with the sanitary or phytosanitary measures of importing Members, and as a consequence in access to markets, and also in the formulation and application of sanitary or phytosanitary measures in their own territories, and desiring to assist them in their endeavours in this regard;

*Desiring* therefore to elaborate rules for the application of the provisions of GATT 1994 which relate to the use of sanitary or phytosanitary measures, in particular the provisions of Article XX(b);

*Hereby agree* as follows:

### *Article 1*

#### *General Provisions*

1. This Agreement applies to all sanitary and phytosanitary measures which may, directly or indirectly, affect international trade. Such measures shall be developed and applied in accordance with the provisions of this Agreement.

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<sup>1</sup>In this Agreement, reference to Article XX(b) includes also the chapeau of that Article.

2. For the purposes of this Agreement, the definitions provided in Annex A shall apply.
3. The annexes are an integral part of this Agreement.
4. Nothing in this Agreement shall affect the rights of Members under the Agreement on Technical Barriers to Trade with respect to measures not within the scope of this Agreement.

### *Article 2*

#### *Basic Rights and Obligations*

1. Members have the right to take sanitary and phytosanitary measures necessary for the protection of human, animal or plant life or health, provided that such measures are not inconsistent with the provisions of this Agreement.
2. Members shall ensure that any sanitary or phytosanitary measure is applied only to the extent necessary to protect human, animal or plant life or health, is based on scientific principles and is not maintained without sufficient scientific evidence, except as provided for in paragraph 7 of Article 5.
3. Members shall ensure that their sanitary and phytosanitary measures do not arbitrarily or unjustifiably discriminate between Members where identical or similar conditions prevail, including between their own territory and that of other Members. Sanitary and phytosanitary measures shall not be applied in a manner which would constitute a disguised restriction on international trade.
4. Sanitary or phytosanitary measures which conform to the relevant provisions of this Agreement shall be presumed to be in accordance with the obligations of the Members under the provisions of GATT 1994 which relate to the use of sanitary or phytosanitary measures, in particular the provisions of Article XX(b).

### *Article 3*

#### *Harmonization*

1. To harmonize sanitary and phytosanitary measures on as wide a basis as possible, Members shall base their sanitary or phytosanitary measures on international standards, guidelines or recommendations, where they exist, except as otherwise provided for in this Agreement, and in particular in paragraph 3.
2. Sanitary or phytosanitary measures which conform to international standards, guidelines or recommendations shall be deemed to be necessary to protect human, animal or plant life or health, and presumed to be consistent with the relevant provisions of this Agreement and of GATT 1994.
3. Members may introduce or maintain sanitary or phytosanitary measures which result in a higher level of sanitary or phytosanitary protection than would be achieved by measures based on the relevant international standards, guidelines or recommendations, if there is a scientific justification, or as a consequence of the level of sanitary or phytosanitary protection a Member determines to be appropriate

in accordance with the relevant provisions of paragraphs 1 through 8 of Article 5.<sup>2</sup> Notwithstanding the above, all measures which result in a level of sanitary or phytosanitary protection different from that which would be achieved by measures based on international standards, guidelines or recommendations shall not be inconsistent with any other provision of this Agreement.

4. Members shall play a full part, within the limits of their resources, in the relevant international organizations and their subsidiary bodies, in particular the Codex Alimentarius Commission, the International Office of Epizootics, and the international and regional organizations operating within the framework of the International Plant Protection Convention, to promote within these organizations the development and periodic review of standards, guidelines and recommendations with respect to all aspects of sanitary and phytosanitary measures.

5. The Committee on Sanitary and Phytosanitary Measures provided for in paragraphs 1 and 4 of Article 12 (referred to in this Agreement as the "Committee") shall develop a procedure to monitor the process of international harmonization and coordinate efforts in this regard with the relevant international organizations.

#### Article 4

##### *Equivalence*

1. Members shall accept the sanitary or phytosanitary measures of other Members as equivalent, even if these measures differ from their own or from those used by other Members trading in the same product, if the exporting Member objectively demonstrates to the importing Member that its measures achieve the importing Member's appropriate level of sanitary or phytosanitary protection. For this purpose, reasonable access shall be given, upon request, to the importing Member for inspection, testing and other relevant procedures.

2. Members shall, upon request, enter into consultations with the aim of achieving bilateral and multilateral agreements on recognition of the equivalence of specified sanitary or phytosanitary measures.

#### Article 5

##### *Assessment of Risk and Determination of the Appropriate Level of Sanitary or Phytosanitary Protection*

1. Members shall ensure that their sanitary or phytosanitary measures are based on an assessment, as appropriate to the circumstances, of the risks to human, animal or plant life or health, taking into account risk assessment techniques developed by the relevant international organizations.

2. In the assessment of risks, Members shall take into account available scientific evidence; relevant processes and production methods; relevant inspection, sampling and testing methods; prevalence

<sup>2</sup>For the purposes of paragraph 3 of Article 3, there is a scientific justification if, on the basis of an examination and evaluation of available scientific information in conformity with the relevant provisions of this Agreement, a Member determines that the relevant international standards, guidelines or recommendations are not sufficient to achieve its appropriate level of sanitary or phytosanitary protection.

of specific diseases or pests; existence of pest- or disease-free areas; relevant ecological and environmental conditions; and quarantine or other treatment.

3. In assessing the risk to animal or plant life or health and determining the measure to be applied for achieving the appropriate level of sanitary or phytosanitary protection from such risk, Members shall take into account as relevant economic factors: the potential damage in terms of loss of production or sales in the event of the entry, establishment or spread of a pest or disease; the costs of control or eradication in the territory of the importing Member; and the relative cost-effectiveness of alternative approaches to limiting risks.

4. Members should, when determining the appropriate level of sanitary or phytosanitary protection, take into account the objective of minimizing negative trade effects.

5. With the objective of achieving consistency in the application of the concept of appropriate level of sanitary or phytosanitary protection against risks to human life or health, or to animal and plant life or health, each Member shall avoid arbitrary or unjustifiable distinctions in the levels it considers to be appropriate in different situations, if such distinctions result in discrimination or a disguised restriction on international trade. Members shall cooperate in the Committee, in accordance with paragraphs 1, 2 and 3 of Article 12, to develop guidelines to further the practical implementation of this provision. In developing the guidelines, the Committee shall take into account all relevant factors, including the exceptional character of human health risks to which people voluntarily expose themselves.

6. Without prejudice to paragraph 2 of Article 3, when establishing or maintaining sanitary or phytosanitary measures to achieve the appropriate level of sanitary or phytosanitary protection, Members shall ensure that such measures are not more trade-restrictive than required to achieve their appropriate level of sanitary or phytosanitary protection, taking into account technical and economic feasibility.<sup>3</sup>

7. In cases where relevant scientific evidence is insufficient, a Member may provisionally adopt sanitary or phytosanitary measures on the basis of available pertinent information, including that from the relevant international organizations as well as from sanitary or phytosanitary measures applied by other Members. In such circumstances, Members shall seek to obtain the additional information necessary for a more objective assessment of risk and review the sanitary or phytosanitary measure accordingly within a reasonable period of time.

8. When a Member has reason to believe that a specific sanitary or phytosanitary measure introduced or maintained by another Member is constraining, or has the potential to constrain, its exports and the measure is not based on the relevant international standards, guidelines or recommendations, or such standards, guidelines or recommendations do not exist, an explanation of the reasons for such sanitary or phytosanitary measure may be requested and shall be provided by the Member maintaining the measure.

<sup>3</sup>For purposes of paragraph 6 of Article 5, a measure is not more trade-restrictive than required unless there is another measure, reasonably available taking into account technical and economic feasibility, that achieves the appropriate level of sanitary or phytosanitary protection and is significantly less restrictive to trade.

## Article 6

*Adaptation to Regional Conditions, Including Pest- or Disease-Free Areas and Areas of Low Pest or Disease Prevalence*

1. Members shall ensure that their sanitary or phytosanitary measures are adapted to the sanitary or phytosanitary characteristics of the area - whether all of a country, part of a country, or all or parts of several countries - from which the product originated and to which the product is destined. In assessing the sanitary or phytosanitary characteristics of a region, Members shall take into account, *inter alia*, the level of prevalence of specific diseases or pests, the existence of eradication or control programmes, and appropriate criteria or guidelines which may be developed by the relevant international organizations.
2. Members shall, in particular, recognize the concepts of pest- or disease-free areas and areas of low pest or disease prevalence. Determination of such areas shall be based on factors such as geography, ecosystems, epidemiological surveillance, and the effectiveness of sanitary or phytosanitary controls.
3. Exporting Members claiming that areas within their territories are pest- or disease-free areas or areas of low pest or disease prevalence shall provide the necessary evidence thereof in order to objectively demonstrate to the importing Member that such areas are, and are likely to remain, pest- or disease-free areas or areas of low pest or disease prevalence, respectively. For this purpose, reasonable access shall be given, upon request, to the importing Member for inspection, testing and other relevant procedures.

## Article 7

*Transparency*

Members shall notify changes in their sanitary or phytosanitary measures and shall provide information on their sanitary or phytosanitary measures in accordance with the provisions of Annex B.

## Article 8

*Control, Inspection and Approval Procedures*

Members shall observe the provisions of Annex C in the operation of control, inspection and approval procedures, including national systems for approving the use of additives or for establishing tolerances for contaminants in foods, beverages or feedstuffs, and otherwise ensure that their procedures are not inconsistent with the provisions of this Agreement.

## Article 9

*Technical Assistance*

1. Members agree to facilitate the provision of technical assistance to other Members, especially developing country Members, either bilaterally or through the appropriate international organizations. Such assistance may be, *inter alia*, in the areas of processing technologies, research and infrastructure, including in the establishment of national regulatory bodies, and may take the form of advice, credits, donations and grants, including for the purpose of seeking technical expertise, training and equipment to allow such countries to adjust to, and comply with, sanitary or phytosanitary measures necessary to achieve the appropriate level of sanitary or phytosanitary protection in their export markets.
2. Where substantial investments are required in order for an exporting developing country Member to fulfil the sanitary or phytosanitary requirements of an importing Member, the latter shall consider providing such technical assistance as will permit the developing country Member to maintain and expand its market access opportunities for the product involved.

## Article 10

*Special and Differential Treatment*

1. In the preparation and application of sanitary or phytosanitary measures, Members shall take account of the special needs of developing country Members, and in particular of the least-developed country Members.
2. Where the appropriate level of sanitary or phytosanitary protection allows scope for the phased introduction of new sanitary or phytosanitary measures, longer time-frames for compliance should be accorded on products of interest to developing country Members so as to maintain opportunities for their exports.
3. With a view to ensuring that developing country Members are able to comply with the provisions of this Agreement, the Committee is enabled to grant to such countries, upon request, specified, time-limited exceptions in whole or in part from obligations under this Agreement, taking into account their financial, trade and development needs.
4. Members should encourage and facilitate the active participation of developing country Members in the relevant international organizations.

## Article 11

*Consultations and Dispute Settlement*

1. The provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding shall apply to consultations and the settlement of disputes under this Agreement, except as otherwise specifically provided herein.
2. In a dispute under this Agreement involving scientific or technical issues, a panel should seek advice from experts chosen by the panel in consultation with the parties to the dispute. To this end,

the panel may, when it deems it appropriate, establish an advisory technical experts group, or consult the relevant international organizations, at the request of either party to the dispute or on its own initiative.

3. Nothing in this Agreement shall impair the rights of Members under other international agreements, including the right to resort to the good offices or dispute settlement mechanisms of other international organizations or established under any international agreement.

#### *Article 12*

##### *Administration*

1. A Committee on Sanitary and Phytosanitary Measures is hereby established to provide a regular forum for consultations. It shall carry out the functions necessary to implement the provisions of this Agreement and the furtherance of its objectives, in particular with respect to harmonization. The Committee shall reach its decisions by consensus.

2. The Committee shall encourage and facilitate ad hoc consultations or negotiations among Members on specific sanitary or phytosanitary issues. The Committee shall encourage the use of international standards, guidelines or recommendations by all Members and, in this regard, shall sponsor technical consultation and study with the objective of increasing coordination and integration between international and national systems and approaches for approving the use of food additives or for establishing tolerances for contaminants in foods, beverages or feedstuffs.

3. The Committee shall maintain close contact with the relevant international organizations in the field of sanitary and phytosanitary protection, especially with the Codex Alimentarius Commission, the International Office of Epizootics, and the Secretariat of the International Plant Protection Convention, with the objective of securing the best available scientific and technical advice for the administration of this Agreement and in order to ensure that unnecessary duplication of effort is avoided.

4. The Committee shall develop a procedure to monitor the process of international harmonization and the use of international standards, guidelines or recommendations. For this purpose, the Committee should, in conjunction with the relevant international organizations, establish a list of international standards, guidelines or recommendations relating to sanitary or phytosanitary measures which the Committee determines to have a major trade impact. The list should include an indication by Members of those international standards, guidelines or recommendations which they apply as conditions for import or on the basis of which imported products conforming to these standards can enjoy access to their markets. For those cases in which a Member does not apply an international standard, guideline or recommendation as a condition for import, the Member should provide an indication of the reason therefor, and, in particular, whether it considers that the standard is not stringent enough to provide the appropriate level of sanitary or phytosanitary protection. If a Member revises its position, following its indication of the use of a standard, guideline or recommendation as a condition for import, it should provide an explanation for its change and so inform the Secretariat as well as the relevant international organizations, unless such notification and explanation is given according to the procedures of Annex B.

5. In order to avoid unnecessary duplication, the Committee may decide, as appropriate, to use the information generated by the procedures, particularly for notification, which are in operation in the relevant international organizations.

6. The Committee may, on the basis of an initiative from one of the Members, through appropriate channels invite the relevant international organizations or their subsidiary bodies to examine specific matters with respect to a particular standard, guideline or recommendation, including the basis of explanations for non-use given according to paragraph 4.

7. The Committee shall review the operation and implementation of this Agreement three years after the date of entry into force of the WTO Agreement, and thereafter as the need arises. Where appropriate, the Committee may submit to the Council for Trade in Goods proposals to amend the text of this Agreement having regard, *inter alia*, to the experience gained in its implementation.

#### *Article 13*

##### *Implementation*

Members are fully responsible under this Agreement for the observance of all obligations set forth herein. Members shall formulate and implement positive measures and mechanisms in support of the observance of the provisions of this Agreement by other than central government bodies. Members shall take such reasonable measures as may be available to them to ensure that non-governmental entities within their territories, as well as regional bodies in which relevant entities within their territories are members, comply with the relevant provisions of this Agreement. In addition, Members shall not take measures which have the effect of, directly or indirectly, requiring or encouraging such regional or non-governmental entities, or local governmental bodies, to act in a manner inconsistent with the provisions of this Agreement. Members shall ensure that they rely on the services of non-governmental entities for implementing sanitary or phytosanitary measures only if these entities comply with the provisions of this Agreement.

#### *Article 14*

##### *Final Provisions*

The least-developed country Members may delay application of the provisions of this Agreement for a period of five years following the date of entry into force of the WTO Agreement with respect to their sanitary or phytosanitary measures affecting importation or imported products. Other developing country Members may delay application of the provisions of this Agreement, other than paragraph 8 of Article 5 and Article 7, for two years following the date of entry into force of the WTO Agreement with respect to their existing sanitary or phytosanitary measures affecting importation or imported products, where such application is prevented by a lack of technical expertise, technical infrastructure or resources.

## ANNEX A

DEFINITIONS<sup>4</sup>1. *Sanitary or phytosanitary measure* - Any measure applied:

- (a) to protect animal or plant life or health within the territory of the Member from risks arising from the entry, establishment or spread of pests, diseases, disease-carrying organisms or disease-causing organisms;
- (b) to protect human or animal life or health within the territory of the Member from risks arising from additives, contaminants, toxins or disease-causing organisms in foods, beverages or feedstuffs;
- (c) to protect human life or health within the territory of the Member from risks arising from diseases carried by animals, plants or products thereof, or from the entry, establishment or spread of pests; or
- (d) to prevent or limit other damage within the territory of the Member from the entry, establishment or spread of pests.

Sanitary or phytosanitary measures include all relevant laws, decrees, regulations, requirements and procedures including, *inter alia*, end product criteria; processes and production methods; testing, inspection, certification and approval procedures; quarantine treatments including relevant requirements associated with the transport of animals or plants, or with the materials necessary for their survival during transport; provisions on relevant statistical methods, sampling procedures and methods of risk assessment; and packaging and labelling requirements directly related to food safety.

2. *Harmonization* - The establishment, recognition and application of common sanitary and phytosanitary measures by different Members.3. *International standards, guidelines and recommendations*

- (a) for food safety, the standards, guidelines and recommendations established by the Codex Alimentarius Commission relating to food additives, veterinary drug and pesticide residues, contaminants, methods of analysis and sampling, and codes and guidelines of hygienic practice;
- (b) for animal health and zoonoses, the standards, guidelines and recommendations developed under the auspices of the International Office of Epizootics;
- (c) for plant health, the international standards, guidelines and recommendations developed under the auspices of the Secretariat of the International Plant Protection Convention in cooperation with regional organizations operating within the framework of the International Plant Protection Convention; and

<sup>4</sup>For the purpose of these definitions, "animal" includes fish and wild fauna; "plant" includes forests and wild flora; "pests" include weeds; and "contaminants" include pesticide and veterinary drug residues and extraneous matter.

- (d) for matters not covered by the above organizations, appropriate standards, guidelines and recommendations promulgated by other relevant international organizations open for membership to all Members, as identified by the Committee.

4. *Risk assessment* - The evaluation of the likelihood of entry, establishment or spread of a pest or disease within the territory of an importing Member according to the sanitary or phytosanitary measures which might be applied, and of the associated potential biological and economic consequences; or the evaluation of the potential for adverse effects on human or animal health arising from the presence of additives, contaminants, toxins or disease-causing organisms in food, beverages or feedstuffs.

5. *Appropriate level of sanitary or phytosanitary protection* - The level of protection deemed appropriate by the Member establishing a sanitary or phytosanitary measure to protect human, animal or plant life or health within its territory.

NOTE: Many Members otherwise refer to this concept as the "acceptable level of risk".

6. *Pest- or disease-free area* - An area, whether all of a country, part of a country, or all or parts of several countries, as identified by the competent authorities, in which a specific pest or disease does not occur.

NOTE: A pest- or disease-free area may surround, be surrounded by, or be adjacent to an area - whether within part of a country or in a geographic region which includes parts of or all of several countries - in which a specific pest or disease is known to occur but is subject to regional control measures such as the establishment of protection, surveillance and buffer zones which will confine or eradicate the pest or disease in question.

7. *Area of low pest or disease prevalence* - An area, whether all of a country, part of a country, or all or parts of several countries, as identified by the competent authorities, in which a specific pest or disease occurs at low levels and which is subject to effective surveillance, control or eradication measures.

## ANNEX B

## TRANSPARENCY OF SANITARY AND PHYTOSANITARY REGULATIONS

*Publication of regulations*

1. Members shall ensure that all sanitary and phytosanitary regulations<sup>5</sup> which have been adopted are published promptly in such a manner as to enable interested Members to become acquainted with them.
2. Except in urgent circumstances, Members shall allow a reasonable interval between the publication of a sanitary or phytosanitary regulation and its entry into force in order to allow time for producers in exporting Members, and particularly in developing country Members, to adapt their products and methods of production to the requirements of the importing Member.

*Enquiry points*

3. Each Member shall ensure that one enquiry point exists which is responsible for the provision of answers to all reasonable questions from interested Members as well as for the provision of relevant documents regarding:
  - (a) any sanitary or phytosanitary regulations adopted or proposed within its territory;
  - (b) any control and inspection procedures, production and quarantine treatment, pesticide tolerance and food additive approval procedures, which are operated within its territory;
  - (c) risk assessment procedures, factors taken into consideration, as well as the determination of the appropriate level of sanitary or phytosanitary protection;
  - (d) the membership and participation of the Member, or of relevant bodies within its territory, in international and regional sanitary and phytosanitary organizations and systems, as well as in bilateral and multilateral agreements and arrangements within the scope of this Agreement, and the texts of such agreements and arrangements.

4. Members shall ensure that where copies of documents are requested by interested Members, they are supplied at the same price (if any), apart from the cost of delivery, as to the nationals<sup>6</sup> of the Member concerned.

<sup>5</sup>Sanitary and phytosanitary measures such as laws, decrees or ordinances which are applicable generally.

<sup>6</sup>When "nationals" are referred to in this Agreement, the term shall be deemed, in the case of a separate customs territory Member of the WTO, to mean persons, natural or legal, who are domiciled or who have a real and effective industrial or commercial establishment in that customs territory.

*Notification procedures*

5. Whenever an international standard, guideline or recommendation does not exist or the content of a proposed sanitary or phytosanitary regulation is not substantially the same as the content of an international standard, guideline or recommendation, and if the regulation may have a significant effect on trade of other Members, Members shall:
  - (a) publish a notice at an early stage in such a manner as to enable interested Members to become acquainted with the proposal to introduce a particular regulation;
  - (b) notify other Members, through the Secretariat, of the products to be covered by the regulation together with a brief indication of the objective and rationale of the proposed regulation. Such notifications shall take place at an early stage, when amendments can still be introduced and comments taken into account;
  - (c) provide upon request to other Members copies of the proposed regulation and, whenever possible, identify the parts which in substance deviate from international standards, guidelines or recommendations;
  - (d) without discrimination, allow reasonable time for other Members to make comments in writing, discuss these comments upon request, and take the comments and the results of the discussions into account.
6. However, where urgent problems of health protection arise or threaten to arise for a Member, that Member may omit such of the steps enumerated in paragraph 5 of this Annex as it finds necessary, provided that the Member:
  - (a) immediately notifies other Members, through the Secretariat, of the particular regulation and the products covered, with a brief indication of the objective and the rationale of the regulation, including the nature of the urgent problem(s);
  - (b) provides, upon request, copies of the regulation to other Members;
  - (c) allows other Members to make comments in writing, discusses these comments upon request, and takes the comments and the results of the discussions into account.
7. Notifications to the Secretariat shall be in English, French or Spanish.
8. Developed country Members shall, if requested by other Members, provide copies of the documents or, in case of voluminous documents, summaries of the documents covered by a specific notification in English, French or Spanish.
9. The Secretariat shall promptly circulate copies of the notification to all Members and interested international organizations and draw the attention of developing country Members to any notifications relating to products of particular interest to them.
10. Members shall designate a single central government authority as responsible for the implementation, on the national level, of the provisions concerning notification procedures according to paragraphs 5, 6, 7 and 8 of this Annex.

*General reservations*

11. Nothing in this Agreement shall be construed as requiring:

- (a) the provision of particulars or copies of drafts or the publication of texts other than in the language of the Member except as stated in paragraph 8 of this Annex; or
- (b) Members to disclose confidential information which would impede enforcement of sanitary or phytosanitary legislation or which would prejudice the legitimate commercial interests of particular enterprises.

ANNEX C

CONTROL, INSPECTION AND APPROVAL PROCEDURES<sup>7</sup>

1. Members shall ensure, with respect to any procedure to check and ensure the fulfilment of sanitary or phytosanitary measures, that:
  - (a) such procedures are undertaken and completed without undue delay and in no less favourable manner for imported products than for like domestic products;
  - (b) the standard processing period of each procedure is published or that the anticipated processing period is communicated to the applicant upon request; when receiving an application, the competent body promptly examines the completeness of the documentation and informs the applicant in a precise and complete manner of all deficiencies; the competent body transmits as soon as possible the results of the procedure in a precise and complete manner to the applicant so that corrective action may be taken if necessary; even when the application has deficiencies, the competent body proceeds as far as practicable with the procedure if the applicant so requests; and that upon request, the applicant is informed of the stage of the procedure, with any delay being explained;
  - (c) information requirements are limited to what is necessary for appropriate control, inspection and approval procedures, including for approval of the use of additives or for the establishment of tolerances for contaminants in food, beverages or feedstuffs;
  - (d) the confidentiality of information about imported products arising from or supplied in connection with control, inspection and approval is respected in a way no less favourable than for domestic products and in such a manner that legitimate commercial interests are protected;
  - (e) any requirements for control, inspection and approval of individual specimens of a product are limited to what is reasonable and necessary;
  - (f) any fees imposed for the procedures on imported products are equitable in relation to any fees charged on like domestic products or products originating in any other Member and should be no higher than the actual cost of the service;
  - (g) the same criteria should be used in the siting of facilities used in the procedures and the selection of samples of imported products as for domestic products so as to minimize the inconvenience to applicants, importers, exporters or their agents;
  - (h) whenever specifications of a product are changed subsequent to its control and inspection in light of the applicable regulations, the procedure for the modified product is limited to what is necessary to determine whether adequate confidence exists that the product still meets the regulations concerned; and

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<sup>7</sup>Control, inspection and approval procedures include, *inter alia*, procedures for sampling, testing and certification.

- (i) a procedure exists to review complaints concerning the operation of such procedures and to take corrective action when a complaint is justified.

Where an importing Member operates a system for the approval of the use of food additives or for the establishment of tolerances for contaminants in food, beverages or feedstuffs which prohibits or restricts access to its domestic markets for products based on the absence of an approval, the importing Member shall consider the use of a relevant international standard as the basis for access until a final determination is made.

2. Where a sanitary or phytosanitary measure specifies control at the level of production, the Member in whose territory the production takes place shall provide the necessary assistance to facilitate such control and the work of the controlling authorities.
3. Nothing in this Agreement shall prevent Members from carrying out reasonable inspection within their own territories.



## **Agreement on Technical Barriers to Trade, 1994**

## AGREEMENT ON TECHNICAL BARRIERS TO TRADE

*Members,*

*Having regard to the Uruguay Round of Multilateral Trade Negotiations;*

*Desiring to further the objectives of GATT 1994;*

*Recognizing the important contribution that international standards and conformity assessment systems can make in this regard by improving efficiency of production and facilitating the conduct of international trade;*

*Desiring therefore to encourage the development of such international standards and conformity assessment systems;*

*Desiring however to ensure that technical regulations and standards, including packaging, marking and labelling requirements, and procedures for assessment of conformity with technical regulations and standards do not create unnecessary obstacles to international trade;*

*Recognizing that no country should be prevented from taking measures necessary to ensure the quality of its exports, or for the protection of human, animal or plant life or health, of the environment, or for the prevention of deceptive practices, at the levels it considers appropriate, subject to the requirement that they 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, and are otherwise in accordance with the provisions of this Agreement;*

*Recognizing that no country should be prevented from taking measures necessary for the protection of its essential security interest;*

*Recognizing the contribution which international standardization can make to the transfer of technology from developed to developing countries;*

*Recognizing that developing countries may encounter special difficulties in the formulation and application of technical regulations and standards and procedures for assessment of conformity with technical regulations and standards, and desiring to assist them in their endeavours in this regard;*

Hereby agree as follows:

### Article I

#### General Provisions

1.1 General terms for standardization and procedures for assessment of conformity shall normally have the meaning given to them by definitions adopted within the United Nations system and by international standardizing bodies taking into account their context and in the light of the object and purpose of this Agreement.

1.2 However, for the purposes of this Agreement the meaning of the terms given in Annex 1 applies.

1.3 All products, including industrial and agricultural products, shall be subject to the provisions of this Agreement.

1.4 Purchasing specifications prepared by governmental bodies for production or consumption requirements of governmental bodies are not subject to the provisions of this Agreement but are addressed in the Agreement on Government Procurement, according to its coverage.

1.5 The provisions of this Agreement do not apply to sanitary and phytosanitary measures as defined in Annex A of the Agreement on the Application of Sanitary and Phytosanitary Measures.

1.6 All references in this Agreement to technical regulations, standards and conformity assessment procedures shall be construed to include any amendments thereto and any additions to the rules or the product coverage thereof, except amendments and additions of an insignificant nature.

## TECHNICAL REGULATIONS AND STANDARDS

### Article 2

#### Preparation, Adoption and Application of Technical Regulations by Central Government Bodies

With respect to their central government bodies:

2.1 Members shall ensure that in respect of technical regulations, products imported from the territory of any Member shall be accorded treatment no less favourable than that accorded to like products of national origin and to like products originating in any other country.

2.2 Members shall ensure that technical regulations are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade. For this purpose, technical regulations shall not be more trade-restrictive than necessary to fulfil a legitimate objective, taking account of the risks non-fulfilment would create. Such legitimate objectives are, *inter alia*: national security requirements; the prevention of deceptive practices; protection of human health or safety, animal or plant life or health, or the environment. In assessing such risks, relevant elements of consideration are, *inter alia*: available scientific and technical information, related processing technology or intended end-uses of products.

2.3 Technical regulations shall not be maintained if the circumstances or objectives giving rise to their adoption no longer exist or if the changed circumstances or objectives can be addressed in a less trade-restrictive manner.

2.4 Where technical regulations are required and relevant international standards exist or their completion is imminent, Members shall use them, or the relevant parts of them, as a basis for their technical regulations except when such international standards or relevant parts would be an ineffective or inappropriate means for the fulfilment of the legitimate objectives pursued, for instance because of fundamental climatic or geographical factors or fundamental technological problems.

2.5 A Member preparing, adopting or applying a technical regulation which may have a significant effect on trade of other Members shall, upon the request of another Member, explain the justification for that technical regulation in terms of the provisions of paragraphs 2 to 4. Whenever a technical regulation is prepared, adopted or applied for one of the legitimate objectives explicitly mentioned in paragraph 2, and is in accordance with relevant international standards, it shall be rebuttably presumed not to create an unnecessary obstacle to international trade.

- 2.6 With a view to harmonizing technical regulations on as wide a basis as possible, Members shall play a full part, within the limits of their resources, in the preparation by appropriate international standardizing bodies of international standards for products for which they either have adopted, or expect to adopt, technical regulations.
- 2.7 Members shall give positive consideration to accepting as equivalent technical regulations of other Members, even if these regulations differ from their own, provided they are satisfied that these regulations adequately fulfil the objectives of their own regulations.
- 2.8 Wherever appropriate, Members shall specify technical regulations based on product requirements in terms of performance rather than design or descriptive characteristics.
- 2.9 Whenever a relevant international standard does not exist or the technical content of a proposed technical regulation is not in accordance with the technical content of relevant international standards, and if the technical regulation may have a significant effect on trade of other Members, Members shall:
- 2.9.1 publish a notice in a publication at an early appropriate stage, in such a manner as to enable interested parties in other Members to become acquainted with it, that they propose to introduce a particular technical regulation;
  - 2.9.2 notify other Members through the Secretariat of the products to be covered by the proposed technical regulation, together with a brief indication of its objective and rationale. Such notifications shall take place at an early appropriate stage, when amendments can still be introduced and comments taken into account;
  - 2.9.3 upon request, provide to other Members particulars or copies of the proposed technical regulation and, whenever possible, identify the parts which in substance deviate from relevant international standards;
  - 2.9.4 without discrimination, allow reasonable time for other Members to make comments in writing, discuss these comments upon request, and take these written comments and the results of these discussions into account.
- 2.10 Subject to the provisions in the lead-in to paragraph 9, where urgent problems of safety, health, environmental protection or national security arise or threaten to arise for a Member, that Member may omit such of the steps enumerated in paragraph 9 as it finds necessary, provided that the Member, upon adoption of a technical regulation, shall:
- 2.10.1 notify immediately other Members through the Secretariat of the particular technical regulation and the products covered, with a brief indication of the objective and the rationale of the technical regulation, including the nature of the urgent problems;
  - 2.10.2 upon request, provide other Members with copies of the technical regulation;
  - 2.10.3 without discrimination, allow other Members to present their comments in writing, discuss these comments upon request, and take these written comments and the results of these discussions into account.
- 2.11 Members shall ensure that all technical regulations which have been adopted are published promptly or otherwise made available in such a manner as to enable interested parties in other Members to become acquainted with them.

2.12 Except in those urgent circumstances referred to in paragraph 10, Members shall allow a reasonable interval between the publication of technical regulations and their entry into force in order to allow time for producers in exporting Members, and particularly in developing country Members, to adapt their products or methods of production to the requirements of the importing Member.

### Article 3

#### *Preparation, Adoption and Application of Technical Regulations by Local Government Bodies and Non-Governmental Bodies*

With respect to their local government and non-governmental bodies within their territories:

- 3.1 Members shall take such reasonable measures as may be available to them to ensure compliance by such bodies with the provisions of Article 2, with the exception of the obligation to notify as referred to in paragraphs 9.2 and 10.1 of Article 2.
- 3.2 Members shall ensure that the technical regulations of local governments on the level directly below that of the central government in Members are notified in accordance with the provisions of paragraphs 9.2 and 10.1 of Article 2, noting that notification shall not be required for technical regulations the technical content of which is substantially the same as that of previously notified technical regulations of central government bodies of the Member concerned.
- 3.3 Members may require contact with other Members, including the notifications, provision of information, comments and discussions referred to in paragraphs 9 and 10 of Article 2, to take place through the central government.
- 3.4 Members shall not take measures which require or encourage local government bodies or non-governmental bodies within their territories to act in a manner inconsistent with the provisions of Article 2.
- 3.5 Members are fully responsible under this Agreement for the observance of all provisions of Article 2. Members shall formulate and implement positive measures and mechanisms in support of the observance of the provisions of Article 2 by other than central government bodies.

### Article 4

#### *Preparation, Adoption and Application of Standards*

- 4.1 Members shall ensure that their central government standardizing bodies accept and comply with the Code of Good Practice for the Preparation, Adoption and Application of Standards in Annex 3 to this Agreement (referred to in this Agreement as the "Code of Good Practice"). They shall take such reasonable measures as may be available to them to ensure that local government and non-governmental standardizing bodies within their territories, as well as regional standardizing bodies of which they or one or more bodies within their territories are members, accept and comply with this Code of Good Practice. In addition, Members shall not take measures which have the effect of, directly or indirectly, requiring or encouraging such standardizing bodies to act in a manner inconsistent with the Code of Good Practice. The obligations of Members with respect to compliance of standardizing bodies with the provisions of the Code of Good Practice shall apply irrespective of whether or not a standardizing body has accepted the Code of Good Practice.

4.2 Standardizing bodies that have accepted and are complying with the Code of Good Practice shall be acknowledged by the Members as complying with the principles of this Agreement.

#### CONFORMITY WITH TECHNICAL REGULATIONS AND STANDARDS

##### Article 5

##### *Procedures for Assessment of Conformity by Central Government Bodies*

5.1 Members shall ensure that, in cases where a positive assurance of conformity with technical regulations or standards is required, their central government bodies apply the following provisions to products originating in the territories of other Members:

- 5.1.1 conformity assessment procedures are prepared, adopted and applied so as to grant access for suppliers of like products originating in the territories of other Members under conditions no less favourable than those accorded to suppliers of like products of national origin or originating in any other country, in a comparable situation; access entails suppliers' right to an assessment of conformity under the rules of the procedure, including, when foreseen by this procedure, the possibility to have conformity assessment activities undertaken at the site of facilities and to receive the mark of the system;
- 5.1.2 conformity assessment procedures are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade. This means, *inter alia*, that conformity assessment procedures shall not be more strict or be applied more strictly than is necessary to give the importing Member adequate confidence that products conform with the applicable technical regulations or standards, taking account of the risks non-conformity would create.

5.2 When implementing the provisions of paragraph 1, Members shall ensure that:

- 5.2.1 conformity assessment procedures are undertaken and completed as expeditiously as possible and in a no less favourable order for products originating in the territories of other Members than for like domestic products;
- 5.2.2 the standard processing period of each conformity assessment procedure is published or that the anticipated processing period is communicated to the applicant upon request; when receiving an application, the competent body promptly examines the completeness of the documentation and informs the applicant in a precise and complete manner of all deficiencies; the competent body transmits as soon as possible the results of the assessment in a precise and complete manner to the applicant so that corrective action may be taken if necessary; even when the application has deficiencies, the competent body proceeds as far as practicable with the conformity assessment if the applicant so requests; and that, upon request, the applicant is informed of the stage of the procedure, with any delay being explained;
- 5.2.3 information requirements are limited to what is necessary to assess conformity and determine fees;
- 5.2.4 the confidentiality of information about products originating in the territories of other Members arising from or supplied in connection with such conformity assessment

procedures is respected in the same way as for domestic products and in such a manner that legitimate commercial interests are protected;

5.2.5 any fees imposed for assessing the conformity of products originating in the territories of other Members are equitable in relation to any fees chargeable for assessing the conformity of like products of national origin or originating in any other country, taking into account communication, transportation and other costs arising from differences between location of facilities of the applicant and the conformity assessment body;

5.2.6 the siting of facilities used in conformity assessment procedures and the selection of samples are not such as to cause unnecessary inconvenience to applicants or their agents;

5.2.7 whenever specifications of a product are changed subsequent to the determination of its conformity to the applicable technical regulations or standards, the conformity assessment procedure for the modified product is limited to what is necessary to determine whether adequate confidence exists that the product still meets the technical regulations or standards concerned;

5.2.8 a procedure exists to review complaints concerning the operation of a conformity assessment procedure and to take corrective action when a complaint is justified.

5.3 Nothing in paragraphs 1 and 2 shall prevent Members from carrying out reasonable spot checks within their territories.

5.4 In cases where a positive assurance is required that products conform with technical regulations or standards, and relevant guides or recommendations issued by international standardizing bodies exist or their completion is imminent, Members shall ensure that central government bodies use them, or the relevant parts of them, as a basis for their conformity assessment procedures, except where, as duly explained upon request, such guides or recommendations or relevant parts are inappropriate for the Members concerned, for, *inter alia*, such reasons as: national security requirements; the prevention of deceptive practices; protection of human health or safety, animal or plant life or health, or the environment; fundamental climatic or other geographical factors; fundamental technological or infrastructural problems.

5.5 With a view to harmonizing conformity assessment procedures on as wide a basis as possible, Members shall play a full part, within the limits of their resources, in the preparation by appropriate international standardizing bodies of guides and recommendations for conformity assessment procedures.

5.6 Whenever a relevant guide or recommendation issued by an international standardizing body does not exist or the technical content of a proposed conformity assessment procedure is not in accordance with relevant guides and recommendations issued by international standardizing bodies, and if the conformity assessment procedure may have a significant effect on trade of other Members, Members shall:

5.6.1 publish a notice in a publication at an early appropriate stage, in such a manner as to enable interested parties in other Members to become acquainted with it, that they propose to introduce a particular conformity assessment procedure;

5.6.2 notify other Members through the Secretariat of the products to be covered by the proposed conformity assessment procedure, together with a brief indication of its objective and rationale. Such notifications shall take place at an early appropriate stage, when amendments can still be introduced and comments taken into account;

- 5.6.3 upon request, provide to other Members particulars or copies of the proposed procedure and, whenever possible, identify the parts which in substance deviate from relevant guides or recommendations issued by international standardizing bodies;
- 5.6.4 without discrimination, allow reasonable time for other Members to make comments in writing, discuss these comments upon request, and take these written comments and the results of these discussions into account.
- 5.7 Subject to the provisions in the lead-in to paragraph 6, where urgent problems of safety, health, environmental protection or national security arise or threaten to arise for a Member, that Member may omit such of the steps enumerated in paragraph 6 as it finds necessary, provided that the Member, upon adoption of the procedure, shall:
- 5.7.1 notify immediately other Members through the Secretariat of the particular procedure and the products covered, with a brief indication of the objective and the rationale of the procedure, including the nature of the urgent problems;
- 5.7.2 upon request, provide other Members with copies of the rules of the procedure;
- 5.7.3 without discrimination, allow other Members to present their comments in writing, discuss these comments upon request, and take these written comments and the results of these discussions into account.
- 5.8 Members shall ensure that all conformity assessment procedures which have been adopted are published promptly or otherwise made available in such a manner as to enable interested parties in other Members to become acquainted with them.
- 5.9 Except in those urgent circumstances referred to in paragraph 7, Members shall allow a reasonable interval between the publication of requirements concerning conformity assessment procedures and their entry into force in order to allow time for producers in exporting Members, and particularly in developing country Members, to adapt their products or methods of production to the requirements of the importing Member.

#### Article 6

##### *Recognition of Conformity Assessment by Central Government Bodies*

With respect to their central government bodies:

- 6.1 Without prejudice to the provisions of paragraphs 3 and 4, Members shall ensure, whenever possible, that results of conformity assessment procedures in other Members are accepted, even when those procedures differ from their own, provided they are satisfied that those procedures offer an assurance of conformity with applicable technical regulations or standards equivalent to their own procedures. It is recognized that prior consultations may be necessary in order to arrive at a mutually satisfactory understanding regarding, in particular:

- 6.1.1 adequate and enduring technical competence of the relevant conformity assessment bodies in the exporting Member, so that confidence in the continued reliability of their conformity assessment results can exist; in this regard, verified compliance, for instance through accreditation, with relevant guides or recommendations issued by international standardizing bodies shall be taken into account as an indication of adequate technical competence;

- 6.1.2 limitation of the acceptance of conformity assessment results to those produced by designated bodies in the exporting Member.
- 6.2 Members shall ensure that their conformity assessment procedures permit, as far as practicable, the implementation of the provisions in paragraph 1.
- 6.3 Members are encouraged, at the request of other Members, to be willing to enter into negotiations for the conclusion of agreements for the mutual recognition of results of each other's conformity assessment procedures. Members may require that such agreements fulfil the criteria of paragraph 1 and give mutual satisfaction regarding their potential for facilitating trade in the products concerned.
- 6.4 Members are encouraged to permit participation of conformity assessment bodies located in the territories of other Members in their conformity assessment procedures under conditions no less favourable than those accorded to bodies located within their territory or the territory of any other country.

#### Article 7

##### *Procedures for Assessment of Conformity by Local Government Bodies*

With respect to their local government bodies within their territories:

- 7.1 Members shall take such reasonable measures as may be available to them to ensure compliance by such bodies with the provisions of Articles 5 and 6, with the exception of the obligation to notify as referred to in paragraphs 6.2 and 7.1 of Article 5.
- 7.2 Members shall ensure that the conformity assessment procedures of local governments on the level directly below that of the central government in Members are notified in accordance with the provisions of paragraphs 6.2 and 7.1 of Article 5, noting that notifications shall not be required for conformity assessment procedures the technical content of which is substantially the same as that of previously notified conformity assessment procedures of central government bodies of the Members concerned.

- 7.3 Members may require contact with other Members, including the notifications, provision of information, comments and discussions referred to in paragraphs 6 and 7 of Article 5, to take place through the central government.

- 7.4 Members shall not take measures which require or encourage local government bodies within their territories to act in a manner inconsistent with the provisions of Articles 5 and 6.

- 7.5 Members are fully responsible under this Agreement for the observance of all provisions of Articles 5 and 6. Members shall formulate and implement positive measures and mechanisms in support of the observance of the provisions of Articles 5 and 6 by other than central government bodies.

#### Article 8

##### *Procedures for Assessment of Conformity by Non-Governmental Bodies*

- 8.1 Members shall take such reasonable measures as may be available to them to ensure that non-governmental bodies within their territories which operate conformity assessment procedures comply with the provisions of Articles 5 and 6, with the exception of the obligation to notify proposed conformity assessment procedures. In addition, Members shall not take measures which have the effect of, directly

or indirectly, requiring or encouraging such bodies to act in a manner inconsistent with the provisions of Articles 5 and 6.

8.2 Members shall ensure that their central government bodies rely on conformity assessment procedures operated by non-governmental bodies only if these latter bodies comply with the provisions of Articles 5 and 6, with the exception of the obligation to notify proposed conformity assessment procedures.

#### *Article 9*

##### *International and Regional Systems*

9.1 Where a positive assurance of conformity with a technical regulation or standard is required, Members shall, wherever practicable, formulate and adopt international systems for conformity assessment and become members thereof or participate therein.

9.2 Members shall take such reasonable measures as may be available to them to ensure that international and regional systems for conformity assessment in which relevant bodies within their territories are members or participants comply with the provisions of Articles 5 and 6. In addition, Members shall not take any measures which have the effect of, directly or indirectly, requiring or encouraging such systems to act in a manner inconsistent with any of the provisions of Articles 5 and 6.

9.3 Members shall ensure that their central government bodies rely on international or regional conformity assessment systems only to the extent that these systems comply with the provisions of Articles 5 and 6, as applicable.

#### INFORMATION AND ASSISTANCE

##### *Article 10*

##### *Information About Technical Regulations, Standards and Conformity Assessment Procedures*

10.1 Each Member shall ensure that an enquiry point exists which is able to answer all reasonable enquiries from other Members and interested parties in other Members as well as to provide the relevant documents regarding:

10.1.1 any technical regulations adopted or proposed within its territory by central or local government bodies, by non-governmental bodies which have legal power to enforce a technical regulation, or by regional standardizing bodies of which such bodies are members or participants;

10.1.2 any standards adopted or proposed within its territory by central or local government bodies, or by regional standardizing bodies of which such bodies are members or participants;

10.1.3 any conformity assessment procedures, or proposed conformity assessment procedures, which are operated within its territory by central or local government bodies, or by non-governmental bodies which have legal power to enforce a technical regulation, or by regional bodies of which such bodies are members or participants;

10.1.4 the membership and participation of the Member, or of relevant central or local government bodies within its territory, in international and regional standardizing bodies and conformity assessment systems, as well as in bilateral and multilateral arrangements within the scope of this Agreement; it shall also be able to provide reasonable information on the provisions of such systems and arrangements;

10.1.5 the location of notices published pursuant to this Agreement, or the provision of information as to where such information can be obtained; and

10.1.6 the location of the enquiry points mentioned in paragraph 3.

10.2 If, however, for legal or administrative reasons more than one enquiry point is established by a Member, that Member shall provide to the other Members complete and unambiguous information on the scope of responsibility of each of these enquiry points. In addition, that Member shall ensure that any enquiries addressed to an incorrect enquiry point shall promptly be conveyed to the correct enquiry point.

10.3 Each Member shall take such reasonable measures as may be available to it to ensure that one or more enquiry points exist which are able to answer all reasonable enquiries from other Members and interested parties in other Members as well as to provide the relevant documents or information as to where they can be obtained regarding:

10.3.1 any standards adopted or proposed within its territory by non-governmental standardizing bodies, or by regional standardizing bodies of which such bodies are members or participants; and

10.3.2 any conformity assessment procedures, or proposed conformity assessment procedures, which are operated within its territory by non-governmental bodies, or by regional bodies of which such bodies are members or participants;

10.3.3 the membership and participation of relevant non-governmental bodies within its territory in international and regional standardizing bodies and conformity assessment systems, as well as in bilateral and multilateral arrangements within the scope of this Agreement; they shall also be able to provide reasonable information on the provisions of such systems and arrangements.

10.4 Members shall take such reasonable measures as may be available to them to ensure that where copies of documents are requested by other Members or by interested parties in other Members, in accordance with the provisions of this Agreement, they are supplied at an equitable price (if any) which shall, apart from the real cost of delivery, be the same for the nationals<sup>1</sup> of the Member concerned or of any other Member.

10.5 Developed country Members shall, if requested by other Members, provide, in English, French or Spanish, translations of the documents covered by a specific notification or, in case of voluminous documents, of summaries of such documents.

10.6 The Secretariat shall, when it receives notifications in accordance with the provisions of this Agreement, circulate copies of the notifications to all Members and interested international standardizing

<sup>1</sup>"Nationals" here shall be deemed, in the case of a separate customs territory Member of the WTO, to mean persons, natural or legal, who are domiciled or who have a real and effective industrial or commercial establishment in that customs territory.

and conformity assessment bodies, and draw the attention of developing country Members to any notifications relating to products of particular interest to them.

10.7 Whenever a Member has reached an agreement with any other country or countries on issues related to technical regulations, standards or conformity assessment procedures which may have a significant effect on trade, at least one Member party to the agreement shall notify other Members through the Secretariat of the products to be covered by the agreement and include a brief description of the agreement. Members concerned are encouraged to enter, upon request, into consultations with other Members for the purposes of concluding similar agreements or of arranging for their participation in such agreements.

10.8 Nothing in this Agreement shall be construed as requiring:

10.8.1 the publication of texts other than in the language of the Member;

10.8.2 the provision of particulars or copies of drafts other than in the language of the Member except as stated in paragraph 5; or

10.8.3 Members to furnish any information, the disclosure of which they consider contrary to their essential security interests.

10.9 Notifications to the Secretariat shall be in English, French or Spanish.

10.10 Members shall designate a single central government authority that is responsible for the implementation on the national level of the provisions concerning notification procedures under this Agreement except those included in Annex 3.

10.11 If, however, for legal or administrative reasons the responsibility for notification procedures is divided among two or more central government authorities, the Member concerned shall provide to the other Members complete and unambiguous information on the scope of responsibility of each of these authorities.

#### Article 11

##### *Technical Assistance to Other Members*

11.1 Members shall, if requested, advise other Members, especially the developing country Members, on the preparation of technical regulations.

11.2 Members shall, if requested, advise other Members, especially the developing country Members, and shall grant them technical assistance on mutually agreed terms and conditions regarding the establishment of national standardizing bodies, and participation in the international standardizing bodies, and shall encourage their national standardizing bodies to do likewise.

11.3 Members shall, if requested, take such reasonable measures as may be available to them to arrange for the regulatory bodies within their territories to advise other Members, especially the developing country Members, and shall grant them technical assistance on mutually agreed terms and conditions regarding:

11.3.1 the establishment of regulatory bodies, or bodies for the assessment of conformity with technical regulations; and

11.3.2 the methods by which their technical regulations can best be met.

11.4 Members shall, if requested, take such reasonable measures as may be available to them to arrange for advice to be given to other Members, especially the developing country Members, and shall grant them technical assistance on mutually agreed terms and conditions regarding the establishment of bodies for the assessment of conformity with standards adopted within the territory of the requesting Member.

11.5 Members shall, if requested, advise other Members, especially the developing country Members, and shall grant them technical assistance on mutually agreed terms and conditions regarding the steps that should be taken by their producers if they wish to have access to systems for conformity assessment operated by governmental or non-governmental bodies within the territory of the Member receiving the request.

11.6 Members which are members or participants of international or regional systems for conformity assessment shall, if requested, advise other Members, especially the developing country Members, and shall grant them technical assistance on mutually agreed terms and conditions regarding the establishment of the institutions and legal framework which would enable them to fulfil the obligations of membership or participation in such systems.

11.7 Members shall, if so requested, encourage bodies within their territories which are members or participants of international or regional systems for conformity assessment to advise other Members, especially the developing country Members, and should consider requests for technical assistance from them regarding the establishment of the institutions which would enable the relevant bodies within their territories to fulfil the obligations of membership or participation.

11.8 In providing advice and technical assistance to other Members in terms of paragraphs 1 to 7, Members shall give priority to the needs of the least-developed country Members.

#### Article 12

##### *Special and Differential Treatment of Developing Country Members*

12.1 Members shall provide differential and more favourable treatment to developing country Members to this Agreement, through the following provisions as well as through the relevant provisions of other Articles of this Agreement.

12.2 Members shall give particular attention to the provisions of this Agreement concerning developing country Members' rights and obligations and shall take into account the special development, financial and trade needs of developing country Members in the implementation of this Agreement, both nationally and in the operation of this Agreement's institutional arrangements.

12.3 Members shall, in the preparation and application of technical regulations, standards and conformity assessment procedures, take account of the special development, financial and trade needs of developing country Members, with a view to ensuring that such technical regulations, standards and conformity assessment procedures do not create unnecessary obstacles to exports from developing country Members.

12.4 Members recognize that, although international standards, guides or recommendations may exist, in their particular technological and socio-economic conditions, developing country Members adopt certain technical regulations, standards or conformity assessment procedures aimed at preserving indigenous technology and production methods and processes compatible with their development needs.

Members therefore recognize that developing country Members should not be expected to use international standards as a basis for their technical regulations or standards, including test methods, which are not appropriate to their development, financial and trade needs.

12.5 Members shall take such reasonable measures as may be available to them to ensure that international standardizing bodies and international systems for conformity assessment are organized and operated in a way which facilitates active and representative participation of relevant bodies in all Members, taking into account the special problems of developing country Members.

12.6 Members shall take such reasonable measures as may be available to them to ensure that international standardizing bodies, upon request of developing country Members, examine the possibility of, and, if practicable, prepare international standards concerning products of special interest to developing country Members.

12.7 Members shall, in accordance with the provisions of Article 11, provide technical assistance to developing country Members to ensure that the preparation and application of technical regulations, standards and conformity assessment procedures do not create unnecessary obstacles to the expansion and diversification of exports from developing country Members. In determining the terms and conditions of the technical assistance, account shall be taken of the stage of development of the requesting Members and in particular of the least-developed country Members.

12.8 It is recognized that developing country Members may face special problems, including institutional and infrastructural problems, in the field of preparation and application of technical regulations, standards and conformity assessment procedures. It is further recognized that the special development and trade needs of developing country Members, as well as their stage of technological development, may hinder their ability to discharge fully their obligations under this Agreement. Members, therefore, shall take this fact fully into account. Accordingly, with a view to ensuring that developing country Members are able to comply with this Agreement, the Committee on Technical Barriers to Trade provided for in Article 13 (referred to in this Agreement as the "Committee") is enabled to grant, upon request, specified, time-limited exceptions in whole or in part from obligations under this Agreement. When considering such requests the Committee shall take into account the special problems, in the field of preparation and application of technical regulations, standards and conformity assessment procedures, and the special development and trade needs of the developing country Member, as well as its stage of technological development, which may hinder its ability to discharge fully its obligations under this Agreement. The Committee shall, in particular, take into account the special problems of the least-developed country Members.

12.9 During consultations, developed country Members shall bear in mind the special difficulties experienced by developing country Members in formulating and implementing standards and technical regulations and conformity assessment procedures, and in their desire to assist developing country Members with their efforts in this direction, developed country Members shall take account of the special needs of the former in regard to financing, trade and development.

12.10 The Committee shall examine periodically the special and differential treatment, as laid down in this Agreement, granted to developing country Members on national and international levels.

## INSTITUTIONS, CONSULTATION AND DISPUTE SETTLEMENT

### Article 13

#### *The Committee on Technical Barriers to Trade*

13.1 A Committee on Technical Barriers to Trade is hereby established, and shall be composed of representatives from each of the Members. The Committee shall elect its own Chairman and shall meet as necessary, but no less than once a year, for the purpose of affording Members the opportunity of consulting on any matters relating to the operation of this Agreement or the furtherance of its objectives, and shall carry out such responsibilities as assigned to it under this Agreement or by the Members.

13.2 The Committee shall establish working parties or other bodies as may be appropriate, which shall carry out such responsibilities as may be assigned to them by the Committee in accordance with the relevant provisions of this Agreement.

13.3 It is understood that unnecessary duplication should be avoided between the work under this Agreement and that of governments in other technical bodies. The Committee shall examine this problem with a view to minimizing such duplication.

### Article 14

#### *Consultation and Dispute Settlement*

14.1 Consultations and the settlement of disputes with respect to any matter affecting the operation of this Agreement shall take place under the auspices of the Dispute Settlement Body and shall follow, *mutatis mutandis*, the provisions of Articles XXII and XXIII of GATT 1994, as elaborated and applied by the Dispute Settlement Understanding.

14.2 At the request of a party to a dispute, or at its own initiative, a panel may establish a technical expert group to assist in questions of a technical nature, requiring detailed consideration by experts.

14.3 Technical expert groups shall be governed by the procedures of Annex 2.

14.4 The dispute settlement provisions set out above can be invoked in cases where a Member considers that another Member has not achieved satisfactory results under Articles 3, 4, 7, 8 and 9 and its trade interests are significantly affected. In this respect, such results shall be equivalent to those as if the body in question were a Member.

## FINAL PROVISIONS

### Article 15

#### *Final Provisions*

#### *Reservations*

15.1 Reservations may not be entered in respect of any of the provisions of this Agreement without the consent of the other Members.

*Review*

15.2 Each Member shall, promptly after the date on which the WTO Agreement enters into force for it, inform the Committee of measures in existence or taken to ensure the implementation and administration of this Agreement. Any changes of such measures thereafter shall also be notified to the Committee.

15.3 The Committee shall review annually the implementation and operation of this Agreement taking into account the objectives thereof.

15.4 Not later than the end of the third year from the date of entry into force of the WTO Agreement and at the end of each three-year period thereafter, the Committee shall review the operation and implementation of this Agreement, including the provisions relating to transparency, with a view to recommending an adjustment of the rights and obligations of this Agreement where necessary to ensure mutual economic advantage and balance of rights and obligations, without prejudice to the provisions of Article 12. Having regard, *inter alia*, to the experience gained in the implementation of the Agreement, the Committee shall, where appropriate, submit proposals for amendments to the text of this Agreement to the Council for Trade in Goods.

*Annexes*

15.5 The annexes to this Agreement constitute an integral part thereof.

## ANNEX 1

TERMS AND THEIR DEFINITIONS FOR THE  
PURPOSE OF THIS AGREEMENT

The terms presented in the sixth edition of the ISO/IEC Guide 2: 1991, General Terms and Their Definitions Concerning Standardization and Related Activities, shall, when used in this Agreement, have the same meaning as given in the definitions in the said Guide taking into account that services are excluded from the coverage of this Agreement.

For the purpose of this Agreement, however, the following definitions shall apply:

1. *Technical regulation*

Document which lays down product characteristics or their related processes and production methods, including the applicable administrative provisions, with which compliance is mandatory. It may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method.

*Explanatory note*

The definition in ISO/IEC Guide 2 is not self-contained, but based on the so-called "building block" system.

2. *Standard*

Document approved by a recognized body, that provides, for common and repeated use, rules, guidelines or characteristics for products or related processes and production methods, with which compliance is not mandatory. It may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method.

*Explanatory note*

The terms as defined in ISO/IEC Guide 2 cover products, processes and services. This Agreement deals only with technical regulations, standards and conformity assessment procedures related to products or processes and production methods. Standards as defined by ISO/IEC Guide 2 may be mandatory or voluntary. For the purpose of this Agreement standards are defined as voluntary and technical regulations as mandatory documents. Standards prepared by the international standardization community are based on consensus. This Agreement covers also documents that are not based on consensus.

3. *Conformity assessment procedures*

Any procedure used, directly or indirectly, to determine that relevant requirements in technical regulations or standards are fulfilled.

*Explanatory note*

Conformity assessment procedures include, *inter alia*, procedures for sampling, testing and inspection; evaluation, verification and assurance of conformity; registration, accreditation and approval as well as their combinations.

4. *International body or system*

Body or system whose membership is open to the relevant bodies of at least all Members.

5. *Regional body or system*

Body or system whose membership is open to the relevant bodies of only some of the Members.

6. *Central government body*

Central government, its ministries and departments or any body subject to the control of the central government in respect of the activity in question.

*Explanatory note:*

In the case of the European Communities the provisions governing central government bodies apply. However, regional bodies or conformity assessment systems may be established within the European Communities, and in such cases would be subject to the provisions of this Agreement on regional bodies or conformity assessment systems.

7. *Local government body*

Government other than a central government (e.g. states, provinces, Länder, cantons, municipalities, etc.), its ministries or departments or any body subject to the control of such a government in respect of the activity in question.

8. *Non-governmental body*

Body other than a central government body or a local government body, including a non-governmental body which has legal power to enforce a technical regulation.

## ANNEX 2

## TECHNICAL EXPERT GROUPS

The following procedures shall apply to technical expert groups established in accordance with the provisions of Article 14.

1. Technical expert groups are under the panel's authority. Their terms of reference and detailed working procedures shall be decided by the panel, and they shall report to the panel.
2. Participation in technical expert groups shall be restricted to persons of professional standing and experience in the field in question.
3. Citizens of parties to the dispute shall not serve on a technical expert group without the joint agreement of the parties to the dispute, except in exceptional circumstances when the panel considers that the need for specialized scientific expertise cannot be fulfilled otherwise. Government officials of parties to the dispute shall not serve on a technical expert group. Members of technical expert groups shall serve in their individual capacities and not as government representatives, nor as representatives of any organization. Governments or organizations shall therefore not give them instructions with regard to matters before a technical expert group.
4. Technical expert groups may consult and seek information and technical advice from any source they deem appropriate. Before a technical expert group seeks such information or advice from a source within the jurisdiction of a Member, it shall inform the government of that Member. Any Member shall respond promptly and fully to any request by a technical expert group for such information as the technical expert group considers necessary and appropriate.
5. The parties to a dispute shall have access to all relevant information provided to a technical expert group, unless it is of a confidential nature. Confidential information provided to the technical expert group shall not be released without formal authorization from the government, organization or person providing the information. Where such information is requested from the technical expert group but release of such information by the technical expert group is not authorized, a non-confidential summary of the information will be provided by the government, organization or person supplying the information.
6. The technical expert group shall submit a draft report to the Members concerned with a view to obtaining their comments, and taking them into account, as appropriate, in the final report, which shall also be circulated to the Members concerned when it is submitted to the panel.

## ANNEX 3

## CODE OF GOOD PRACTICE FOR THE PREPARATION, ADOPTION AND APPLICATION OF STANDARDS

*General Provisions*

- A. For the purposes of this Code the definitions in Annex 1 of this Agreement shall apply.
- B. This Code is open to acceptance by any standardizing body within the territory of a Member of the WTO, whether a central government body, a local government body, or a non-governmental body; to any governmental regional standardizing body one or more members of which are Members of the WTO; and to any non-governmental regional standardizing body one or more members of which are situated within the territory of a Member of the WTO (referred to in this Code collectively as "standardizing bodies" and individually as "the standardizing body").
- C. Standardizing bodies that have accepted or withdrawn from this Code shall notify this fact to the ISO/IEC Information Centre in Geneva. The notification shall include the name and address of the body concerned and the scope of its current and expected standardization activities. The notification may be sent either directly to the ISO/IEC Information Centre, or through the national member body of ISO/IEC or, preferably, through the relevant national member or international affiliate of ISONET, as appropriate.

## SUBSTANTIVE PROVISIONS

- D. In respect of standards, the standardizing body shall accord treatment to products originating in the territory of any other Member of the WTO no less favourable than that accorded to like products of national origin and to like products originating in any other country.
- E. The standardizing body shall ensure that standards are not prepared, adopted or applied with a view to, or with the effect of, creating unnecessary obstacles to international trade.
- F. Where international standards exist or their completion is imminent, the standardizing body shall use them, or the relevant parts of them, as a basis for the standards it develops, except where such international standards or relevant parts would be ineffective or inappropriate, for instance, because of an insufficient level of protection or fundamental climatic or geographical factors or fundamental technological problems.
- G. With a view to harmonizing standards on as wide a basis as possible, the standardizing body shall, in an appropriate way, play a full part, within the limits of its resources, in the preparation by relevant international standardizing bodies of international standards regarding subject matter for which it either has adopted, or expects to adopt, standards. For standardizing bodies within the territory of a Member, participation in a particular international standardization activity shall, whenever possible, take place through one delegation representing all standardizing bodies in the territory that have adopted, or expect to adopt, standards for the subject matter to which the international standardization activity relates.
- H. The standardizing body within the territory of a Member shall make every effort to avoid duplication of, or overlap with, the work of other standardizing bodies in the national territory or with the work of relevant international or regional standardizing bodies. They shall also make every effort to achieve a national consensus on the standards they develop. Likewise the regional standardizing

body shall make every effort to avoid duplication of, or overlap with, the work of relevant international standardizing bodies.

- I. Wherever appropriate, the standardizing body shall specify standards based on product requirements in terms of performance rather than design or descriptive characteristics.
- J. At least once every six months, the standardizing body shall publish a work programme containing its name and address, the standards it is currently preparing and the standards which it has adopted in the preceding period. A standard is under preparation from the moment a decision has been taken to develop a standard until that standard has been adopted. The titles of specific draft standards shall, upon request, be provided in English, French or Spanish. A notice of the existence of the work programme shall be published in a national or, as the case may be, regional publication of standardization activities.
- The work programme shall for each standard indicate, in accordance with any ISONET rules, the classification relevant to the subject matter, the stage attained in the standard's development, and the references of any international standards taken as a basis. No later than at the time of publication of its work programme, the standardizing body shall notify the existence thereof to the ISO/IEC Information Centre in Geneva.

The notification shall contain the name and address of the standardizing body, the name and issue of the publication in which the work programme is published, the period to which the work programme applies, its price (if any), and how and where it can be obtained. The notification may be sent directly to the ISO/IEC Information Centre, or, preferably, through the relevant national member or international affiliate of ISONET, as appropriate.

- K. The national member of ISO/IEC shall make every effort to become a member of ISONET or to appoint another body to become a member as well as to acquire the most advanced membership type possible for the ISONET member. Other standardizing bodies shall make every effort to associate themselves with the ISONET member.

L. Before adopting a standard, the standardizing body shall allow a period of at least 60 days for the submission of comments on the draft standard by interested parties within the territory of a Member of the WTO. This period may, however, be shortened in cases where urgent problems of safety, health or environment arise or threaten to arise. No later than at the start of the comment period, the standardizing body shall publish a notice announcing the period for commenting in the publication referred to in paragraph J. Such notification shall include, as far as practicable, whether the draft standard deviates from relevant international standards.

M. On the request of any interested party within the territory of a Member of the WTO, the standardizing body shall promptly provide, or arrange to provide, a copy of a draft standard which it has submitted for comments. Any fees charged for this service shall, apart from the real cost of delivery, be the same for foreign and domestic parties.

N. The standardizing body shall take into account, in the further processing of the standard, the comments received during the period for commenting. Comments received through standardizing bodies that have accepted this Code of Good Practice shall, if so requested, be replied to as promptly as possible. The reply shall include an explanation why a deviation from relevant international standards is necessary.

O. Once the standard has been adopted, it shall be promptly published.

P. On the request of any interested party within the territory of a Member of the WTO, the standardizing body shall promptly provide, or arrange to provide, a copy of its most recent work

programme or of a standard which it produced. Any fees charged for this service shall, apart from the real cost of delivery, be the same for foreign and domestic parties.

Q. The standardizing body shall afford sympathetic consideration to, and adequate opportunity for, consultation regarding representations with respect to the operation of this Code presented by standardizing bodies that have accepted this Code of Good Practice. It shall make an objective effort to solve any complaints.

**Agreement on Implementation of Article VI of the  
General Agreement on Tariffs and Trade 1994, 1994**

## AGREEMENT ON IMPLEMENTATION OF ARTICLE VI OF THE GENERAL AGREEMENT ON TARIFFS AND TRADE 1994

Members hereby agree as follows:

### PART I

#### Article 1

##### *Principles*

An anti-dumping measure shall be applied only under the circumstances provided for in Article VI of GATT 1994 and pursuant to investigations initiated<sup>1</sup> and conducted in accordance with the provisions of this Agreement. The following provisions govern the application of Article VI of GATT 1994 in so far as action is taken under anti-dumping legislation or regulations.

#### Article 2

##### *Determination of Dumping*

2.1 For the purpose of this Agreement, a product is to be considered as being dumped, i.e. introduced into the commerce of another country at less than its normal value, if the export price of the product exported from one country to another is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country.

2.2 When there are no sales of the like product in the ordinary course of trade in the domestic market of the exporting country or when, because of the particular market situation or the low volume of the sales in the domestic market of the exporting country<sup>2</sup>, such sales do not permit a proper comparison, the margin of dumping shall be determined by comparison with a comparable price of the like product when exported to an appropriate third country, provided that this price is representative, or with the cost of production in the country of origin plus a reasonable amount for administrative, selling and general costs and for profits.

2.2.1 Sales of the like product in the domestic market of the exporting country or sales to a third country at prices below per unit (fixed and variable) costs of production plus administrative, selling and general costs may be treated as not being in the ordinary course of trade by reason of price and may be disregarded in determining normal value only if the authorities<sup>3</sup> determine that such sales are made within an extended period of time<sup>4</sup> in substantial

<sup>1</sup> The term "initiated" as used in this Agreement means the procedural action by which a Member formally commences an investigation as provided in Article 5.

<sup>2</sup> Sales of the like product destined for consumption in the domestic market of the exporting country shall normally be considered a sufficient quantity for the determination of the normal value if such sales constitute 5 per cent or more of the sales of the product under consideration to the importing Member, provided that a lower ratio should be acceptable where the evidence demonstrates that domestic sales at such lower ratio are nonetheless of sufficient magnitude to provide for a proper comparison.

<sup>3</sup> When in this Agreement the term "authorities" is used, it shall be interpreted as meaning authorities at an appropriate senior level.

<sup>4</sup> The extended period of time should normally be one year but shall in no case be less than six months.

quantities<sup>5</sup> and are at prices which do not provide for the recovery of all costs within a reasonable period of time. If prices which are below per unit costs at the time of sale are above weighted average per unit costs for the period of investigation, such prices shall be considered to provide for recovery of costs within a reasonable period of time.

2.2.1.1 For the purpose of paragraph 2, costs shall normally be calculated on the basis of records kept by the exporter or producer under investigation, provided that such records are in accordance with the generally accepted accounting principles of the exporting country and reasonably reflect the costs associated with the production and sale of the product under consideration. Authorities shall consider all available evidence on the proper allocation of costs, including that which is made available by the exporter or producer in the course of the investigation provided that such allocations have been historically utilized by the exporter or producer, in particular in relation to establishing appropriate amortization and depreciation periods and allowances for capital expenditures and other development costs. Unless already reflected in the cost allocations under this sub-paragraph, costs shall be adjusted appropriately for those non-recurring items of cost which benefit future and/or current production, or for circumstances in which costs during the period of investigation are affected by start-up operations.<sup>6</sup>

2.2.2 For the purpose of paragraph 2, the amounts for administrative, selling and general costs and for profits shall be based on actual data pertaining to production and sales in the ordinary course of trade of the like product by the exporter or producer under investigation. When such amounts cannot be determined on this basis, the amounts may be determined on the basis of:

- (i) the actual amounts incurred and realized by the exporter or producer in question in respect of production and sales in the domestic market of the country of origin of the same general category of products;
- (ii) the weighted average of the actual amounts incurred and realized by other exporters or producers subject to investigation in respect of production and sales of the like product in the domestic market of the country of origin;
- (iii) any other reasonable method, provided that the amount for profit so established shall not exceed the profit normally realized by other exporters or producers on sales of products of the same general category in the domestic market of the country of origin.

2.3 In cases where there is no export price or where it appears to the authorities concerned that the export price is unreliable because of association or a compensatory arrangement between the exporter and the importer or a third party, the export price may be constructed on the basis of the price at which the imported products are first resold to an independent buyer, or if the products are not

<sup>5</sup> Sales below per unit costs are made in substantial quantities when the authorities establish that the weighted average selling price of the transactions under consideration for the determination of the normal value is below the weighted average per unit costs, or that the volume of sales below per unit costs represents not less than 20 per cent of the volume sold in transactions under consideration for the determination of the normal value.

<sup>6</sup> The adjustment made for start-up operations shall reflect the costs at the end of the start-up period or, if that period extends beyond the period of investigation, the most recent costs which can reasonably be taken into account by the authorities during the investigation.

resold to an independent buyer, or not resold in the condition as imported, on such reasonable basis as the authorities may determine.

2.4 A fair comparison shall be made between the export price and the normal value. This comparison shall be made at the same level of trade, normally at the ex-factory level, and in respect of sales made at as nearly as possible the same time. Due allowance shall be made in each case, on its merits, for differences which affect price comparability, including differences in conditions and terms of sale, taxation, levels of trade, quantities, physical characteristics, and any other differences which are also demonstrated to affect price comparability.<sup>7</sup> In the cases referred to in paragraph 3, allowances for costs, including duties and taxes, incurred between importation and resale, and for profits accruing, should also be made. If in these cases price comparability has been affected, the authorities shall establish the normal value at a level of trade equivalent to the level of trade of the constructed export price, or shall make due allowance as warranted under this paragraph. The authorities shall indicate to the parties in question what information is necessary to ensure a fair comparison and shall not impose an unreasonable burden of proof on those parties.

2.4.1 When the comparison under paragraph 4 requires a conversion of currencies, such conversion should be made using the rate of exchange on the date of sale<sup>8</sup>, provided that when a sale of foreign currency on forward markets is directly linked to the export sale involved, the rate of exchange in the forward sale shall be used. Fluctuations in exchange rates shall be ignored and in an investigation the authorities shall allow exporters at least 60 days to have adjusted their export prices to reflect sustained movements in exchange rates during the period of investigation.

2.4.2 Subject to the provisions governing fair comparison in paragraph 4, the existence of margins of dumping during the investigation phase shall normally be established on the basis of a comparison of a weighted average normal value with a weighted average of prices of all comparable export transactions or by a comparison of normal value and export prices on a transaction-to-transaction basis. A normal value established on a weighted average basis may be compared to prices of individual export transactions if the authorities find a pattern of export prices which differ significantly among different purchasers, regions or time periods, and if an explanation is provided as to why such differences cannot be taken into account appropriately by the use of a weighted average-to-weighted average or transaction-to-transaction comparison.

2.5 In the case where products are not imported directly from the country of origin but are exported to the importing Member from an intermediate country, the price at which the products are sold from the country of export to the importing Member shall normally be compared with the comparable price in the country of export. However, comparison may be made with the price in the country of origin, if, for example, the products are merely transhipped through the country of export, or such products are not produced in the country of export, or there is no comparable price for them in the country of export.

2.6 Throughout this Agreement the term "like product" ("produit similaire") shall be interpreted to mean a product which is identical, i.e. alike in all respects to the product under consideration, or in

<sup>7</sup> It is understood that some of the above factors may overlap, and authorities shall ensure that they do not duplicate adjustments that have been already made under this provision.

<sup>8</sup> Normally, the date of sale would be the date of contract, purchase order, order confirmation, or invoice, whichever establishes the material terms of sale.

the absence of such a product, another product which, although not alike in all respects, has characteristics closely resembling those of the product under consideration.

2.7 This Article is without prejudice to the second Supplementary Provision to paragraph 1 of Article VI in Annex I to GATT 1994.

### Article 3

#### Determination of Injury<sup>9</sup>

3.1 A determination of injury for purposes of Article VI of GATT 1994 shall be based on positive evidence and involve an objective examination of both (a) the volume of the dumped imports and the effect of the dumped imports on prices in the domestic market for like products, and (b) the consequent impact of these imports on domestic producers of such products.

3.2 With regard to the volume of the dumped imports, the investigating authorities shall consider whether there has been a significant increase in dumped imports, either in absolute terms or relative to production or consumption in the importing Member. With regard to the effect of the dumped imports on prices, the investigating authorities shall consider whether there has been a significant price undercutting by the dumped imports as compared with the price of a like product of the importing Member, or whether the effect of such imports is otherwise to depress prices to a significant degree or prevent price increases, which otherwise would have occurred, to a significant degree. No one or several of these factors can necessarily give decisive guidance.

3.3 Where imports of a product from more than one country are simultaneously subject to anti-dumping investigations, the investigating authorities may cumulatively assess the effects of such imports only if they determine that (a) the margin of dumping established in relation to the imports from each country is more than *de minimis* as defined in paragraph 8 of Article 5 and the volume of imports from each country is not negligible and (b) a cumulative assessment of the effects of the imports is appropriate in light of the conditions of competition between the imported products and the conditions of competition between the imported products and the like domestic product.

3.4 The examination of the impact of the dumped imports on the domestic industry concerned shall include an evaluation of all relevant economic factors and indices having a bearing on the state of the industry, including actual and potential decline in sales, profits, output, market share, productivity, return on investments, or utilization of capacity; factors affecting domestic prices; the magnitude of the margin of dumping; actual and potential negative effects on cash flow, inventories, employment, wages, growth, ability to raise capital or investments. This list is not exhaustive, nor can one or several of these factors necessarily give decisive guidance.

3.5 It must be demonstrated that the dumped imports are, through the effects of dumping, as set forth in paragraphs 2 and 4, causing injury within the meaning of this Agreement. The demonstration of a causal relationship between the dumped imports and the injury to the domestic industry shall be based on an examination of all relevant evidence before the authorities. The authorities shall also examine any known factors other than the dumped imports which at the same time are injuring the domestic industry, and the injuries caused by these other factors must not be attributed to the dumped imports. Factors which may be relevant in this respect include, *inter alia*, the volume and prices of imports not sold at dumping prices, contraction in demand or changes in the patterns of consumption,

<sup>9</sup> Under this Agreement the term "injury" shall, unless otherwise specified, be taken to mean material injury to a domestic industry, threat of material injury to a domestic industry or material retardation of the establishment of such an industry and shall be interpreted in accordance with the provisions of this Article.

trade restrictive practices of and competition between the foreign and domestic producers, developments in technology and the export performance and productivity of the domestic industry.

3.6 The effect of the dumped imports shall be assessed in relation to the domestic production of the like product when available data permit the separate identification of that production on the basis of such criteria as the production process, producers' sales and profits. If such separate identification of that production is not possible, the effects of the dumped imports shall be assessed by the examination of the production of the narrowest group or range of products, which includes the like product, for which the necessary information can be provided.

3.7 A determination of a threat of material injury shall be based on facts and not merely on allegation, conjecture or remote possibility. The change in circumstances which would create a situation in which the dumping would cause injury must be clearly foreseen and imminent.<sup>10</sup> In making a determination regarding the existence of a threat of material injury, the authorities should consider, *inter alia*, such factors as:

- (i) a significant rate of increase of dumped imports into the domestic market indicating the likelihood of substantially increased importation;
- (ii) sufficient freely disposable, or an imminent, substantial increase in, capacity of the exporter indicating the likelihood of substantially increased dumped exports to the importing Member's market, taking into account the availability of other export markets to absorb any additional exports;
- (iii) whether imports are entering at prices that will have a significant depressing or suppressing effect on domestic prices, and would likely increase demand for further imports; and
- (iv) inventories of the product being investigated.

No one of these factors by itself can necessarily give decisive guidance but the totality of the factors considered must lead to the conclusion that further dumped exports are imminent and that, unless protective action is taken, material injury would occur.

3.8 With respect to cases where injury is threatened by dumped imports, the application of anti-dumping measures shall be considered and decided with special care.

#### Article 4

##### Definition of Domestic Industry

4.1 For the purposes of this Agreement, the term "domestic industry" shall be interpreted as referring to the domestic producers as a whole of the like products or to those of them whose collective output of the products constitutes a major proportion of the total domestic production of those products, except that:

(i) when producers are related<sup>11</sup> to the exporters or importers or are themselves importers of the allegedly dumped product, the term "domestic industry" may be interpreted as referring to the rest of the producers;

(ii) in exceptional circumstances the territory of a Member may, for the production in question, be divided into two or more competitive markets and the producers within each market may be regarded as a separate industry if (a) the producers within such market sell all or almost all of their production of the product in question in that market, and (b) the demand in that market is not to any substantial degree supplied by producers of the product in question located elsewhere in the territory. In such circumstances, injury may be found to exist even where a major portion of the total domestic industry is not injured, provided there is a concentration of dumped imports into such an isolated market and provided further that the dumped imports are causing injury to the producers of all or almost all of the production within such market.

4.2 When the domestic industry has been interpreted as referring to the producers in a certain area, i.e. a market as defined in paragraph 1(ii), anti-dumping duties shall be levied<sup>12</sup> only on the products in question consigned for final consumption to that area. When the constitutional law of the importing Member does not permit the levying of anti-dumping duties on such a basis, the importing Member may levy the anti-dumping duties without limitation only if (a) the exporters shall have been given an opportunity to cease exporting at dumped prices to the area concerned or otherwise give assurances pursuant to Article 8 and adequate assurances in this regard have not been promptly given, and (b) such duties cannot be levied only on products of specific producers which supply the area in question.

4.3 Where two or more countries have reached under the provisions of paragraph 8(a) of Article XXIV of GATT 1994 such a level of integration that they have the characteristics of a single, unified market, the industry in the entire area of integration shall be taken to be the domestic industry referred to in paragraph 1.

4.4 The provisions of paragraph 6 of Article 3 shall be applicable to this Article.

#### Article 5

##### Initiation and Subsequent Investigation

5.1 Except as provided for in paragraph 6, an investigation to determine the existence, degree and effect of any alleged dumping shall be initiated upon a written application by or on behalf of the domestic industry.

5.2 An application under paragraph 1 shall include evidence of (a) dumping, (b) injury within the meaning of Article VI of GATT 1994 as interpreted by this Agreement and (c) a causal link between the dumped imports and the alleged injury. Simple assertion, unsubstantiated by relevant evidence,

<sup>11</sup> For the purpose of this paragraph, producers shall be deemed to be related to exporters or importers only if (a) one of them directly or indirectly controls the other; or (b) both of them are directly or indirectly controlled by a third person; or (c) together they directly or indirectly control a third person, provided that there are grounds for believing or suspecting that the effect of the relationship is such as to cause the producer concerned to behave differently from non-related producers. For the purpose of this paragraph, one shall be deemed to control another when the former is legally or operationally in a position to exercise restraint or direction over the latter.

<sup>12</sup> As used in this Agreement "levy" shall mean the definitive or final legal assessment or collection of a duty or tax.

<sup>10</sup> One example, though not an exclusive one, is that there is convincing reason to believe that there will be, in the near future, substantially increased importation of the product at dumped prices.

cannot be considered sufficient to meet the requirements of this paragraph. The application shall contain such information as is reasonably available to the applicant on the following:

- (i) the identity of the applicant and a description of the volume and value of the domestic production of the like product by the applicant. Where a written application is made on behalf of the domestic industry, the application shall identify the industry on behalf of which the application is made by a list of all known domestic producers of the like product (or associations of domestic producers of the like product) and, to the extent possible, a description of the volume and value of domestic production of the like product accounted for by such producers;
- (ii) a complete description of the allegedly dumped product, the names of the country or countries of origin or export in question, the identity of each known exporter or foreign producer and a list of known persons importing the product in question;
- (iii) information on prices at which the product in question is sold when destined for consumption in the domestic markets of the country or countries of origin or export (or, where appropriate, information on the prices at which the product is sold from the country or countries of origin or export to a third country or countries, or on the constructed value of the product) and information on export prices or, where appropriate, on the prices at which the product is first resold to an independent buyer in the territory of the importing Member;
- (iv) information on the evolution of the volume of the allegedly dumped imports, the effect of these imports on prices of the like product in the domestic market and the consequent impact of the imports on the domestic industry, as demonstrated by relevant factors and indices having a bearing on the state of the domestic industry, such as those listed in paragraphs 2 and 4 of Article 3.

5.3 The authorities shall examine the accuracy and adequacy of the evidence provided in the application to determine whether there is sufficient evidence to justify the initiation of an investigation.

5.4 An investigation shall not be initiated pursuant to paragraph 1 unless the authorities have determined, on the basis of an examination of the degree of support for, or opposition to, the application expressed<sup>13</sup> by domestic producers of the like product, that the application has been made by or on behalf of the domestic industry.<sup>14</sup> The application shall be considered to have been made "by or on behalf of the domestic industry" if it is supported by those domestic producers whose collective output constitutes more than 50 per cent of the total production of the like product produced by that portion of the domestic industry expressing either support for or opposition to the application. However, no investigation shall be initiated when domestic producers expressly supporting the application account for less than 25 per cent of total production of the like product produced by the domestic industry.

5.5 The authorities shall avoid, unless a decision has been made to initiate an investigation, any publicizing of the application for the initiation of an investigation. However, after receipt of a properly documented application and before proceeding to initiate an investigation, the authorities shall notify the government of the exporting Member concerned.

<sup>13</sup> In the case of fragmented industries involving an exceptionally large number of producers, authorities may determine support and opposition by using statistically valid sampling techniques.

<sup>14</sup> Members are aware that in the territory of certain Members employees of domestic producers of the like product or representatives of those employees may make or support an application for an investigation under paragraph 1.

5.6 If, in special circumstances, the authorities concerned decide to initiate an investigation without having received a written application by or on behalf of a domestic industry for the initiation of such investigation, they shall proceed only if they have sufficient evidence of dumping, injury and a causal link, as described in paragraph 2, to justify the initiation of an investigation.

5.7 The evidence of both dumping and injury shall be considered simultaneously (a) in the decision whether or not to initiate an investigation, and (b) thereafter, during the course of the investigation, starting on a date not later than the earliest date on which in accordance with the provisions of this Agreement provisional measures may be applied.

5.8 An application under paragraph 1 shall be rejected and an investigation shall be terminated promptly as soon as the authorities concerned are satisfied that there is not sufficient evidence of either dumping or of injury to justify proceeding with the case. There shall be immediate termination in cases where the authorities determine that the margin of dumping is *de minimis*, or that the volume of dumped imports, actual or potential, or the injury, is negligible. The margin of dumping shall be considered to be *de minimis* if this margin is less than 2 per cent, expressed as a percentage of the export price. The volume of dumped imports shall normally be regarded as negligible if the volume of dumped imports from a particular country is found to account for less than 3 per cent of imports of the like product in the importing Member, unless countries which individually account for less than 3 per cent of the imports of the like product in the importing Member collectively account for more than 7 per cent of imports of the like product in the importing Member.

5.9 An anti-dumping proceeding shall not hinder the procedures of customs clearance.

5.10 Investigations shall, except in special circumstances, be concluded within one year, and in no case more than 18 months, after their initiation.

#### Article 6

#### Evidence

6.1 All interested parties in an anti-dumping investigation shall be given notice of the information which the authorities require and ample opportunity to present in writing all evidence which they consider relevant in respect of the investigation in question.

6.1.1 Exporters or foreign producers receiving questionnaires used in an anti-dumping investigation shall be given at least 30 days for reply.<sup>15</sup> Due consideration should be given to any request for an extension of the 30-day period and, upon cause shown, such an extension should be granted whenever practicable.

6.1.2 Subject to the requirement to protect confidential information, evidence presented in writing by one interested party shall be made available promptly to other interested parties participating in the investigation.

6.1.3 As soon as an investigation has been initiated, the authorities shall provide the full text of the written application received under paragraph 1 of Article 5

<sup>15</sup> As a general rule, the time-limit for exporters shall be counted from the date of receipt of the questionnaire, which for this purpose shall be deemed to have been received one week from the date on which it was sent to the respondent or transmitted to the appropriate diplomatic representative of the exporting Member or, in the case of a separate customs territory Member of the WTO, an official representative of the exporting territory.

to the known exporters<sup>16</sup> and to the authorities of the exporting Member and shall make it available, upon request, to other interested parties involved. Due regard shall be paid to the requirement for the protection of confidential information, as provided for in paragraph 5.

6.2 Throughout the anti-dumping investigation all interested parties shall have a full opportunity for the defence of their interests. To this end, the authorities shall, on request, provide opportunities for all interested parties to meet those parties with adverse interests, so that opposing views may be presented and rebuttal arguments offered. Provision of such opportunities must take account of the need to preserve confidentiality and of the convenience to the parties. There shall be no obligation on any party to attend a meeting, and failure to do so shall not be prejudicial to that party's case. Interested parties shall also have the right, on justification, to present other information orally.

6.3 Oral information provided under paragraph 2 shall be taken into account by the authorities only in so far as it is subsequently reproduced in writing and made available to other interested parties, as provided for in subparagraph 1.2.

6.4 The authorities shall whenever practicable provide timely opportunities for all interested parties to see all information that is relevant to the presentation of their cases, that is not confidential as defined in paragraph 5, and that is used by the authorities in an anti-dumping investigation, and to prepare presentations on the basis of this information.

6.5 Any information which is by nature confidential (for example, because its disclosure would be of significant competitive advantage to a competitor or because its disclosure would have a significantly adverse effect upon a person supplying the information or upon a person from whom that person acquired the information), or which is provided on a confidential basis by parties to an investigation shall, upon good cause shown, be treated as such by the authorities. Such information shall not be disclosed without specific permission of the party submitting it.<sup>17</sup>

6.5.1 The authorities shall require interested parties providing confidential information to furnish non-confidential summaries thereof. These summaries shall be in sufficient detail to permit a reasonable understanding of the substance of the information submitted in confidence. In exceptional circumstances, such parties may indicate that such information is not susceptible of summary. In such exceptional circumstances, a statement of the reasons why summarization is not possible must be provided.

6.5.2 If the authorities find that a request for confidentiality is not warranted and if the supplier of the information is either unwilling to make the information public or to authorize its disclosure in generalized or summary form, the authorities may disregard such information unless it can be demonstrated to their satisfaction from appropriate sources that the information is correct.<sup>18</sup>

6.6 Except in circumstances provided for in paragraph 8, the authorities shall during the course of an investigation satisfy themselves as to the accuracy of the information supplied by interested parties upon which their findings are based.

<sup>16</sup> It being understood that, where the number of exporters involved is particularly high, the full text of the written application should instead be provided only to the authorities of the exporting Member or to the relevant trade association.

<sup>17</sup> Members are aware that in the territory of certain Members disclosure pursuant to a narrowly-drawn protective order may be required.

<sup>18</sup> Members agree that requests for confidentiality should not be arbitrarily rejected.

6.7 In order to verify information provided or to obtain further details, the authorities may carry out investigations in the territory of other Members as required, provided they obtain the agreement of the firms concerned and notify the representatives of the government of the Member in question, and unless that Member objects to the investigation. The procedures described in Annex I shall apply to investigations carried out in the territory of other Members. Subject to the requirement to protect confidential information, the authorities shall make the results of any such investigations available, or shall provide disclosure thereof pursuant to paragraph 9, to the firms to which they pertain and may make such results available to the applicants.

6.8 In cases in which any interested party refuses access to, or otherwise does not provide, necessary information within a reasonable period or significantly impedes the investigation, preliminary and final determinations, affirmative or negative, may be made on the basis of the facts available. The provisions of Annex II shall be observed in the application of this paragraph.

6.9 The authorities shall, before a final determination is made, inform all interested parties of the essential facts under consideration which form the basis for the decision whether to apply definitive measures. Such disclosure should take place in sufficient time for the parties to defend their interests.

6.10 The authorities shall, as a rule, determine an individual margin of dumping for each known exporter or producer concerned of the product under investigation. In cases where the number of exporters, producers, importers or types of products involved is so large as to make such a determination impracticable, the authorities may limit their examination either to a reasonable number of interested parties or products by using samples which are statistically valid on the basis of information available to the authorities at the time of the selection, or to the largest percentage of the volume of the exports from the country in question which can reasonably be investigated.

6.10.1 Any selection of exporters, producers, importers or types of products made under this paragraph shall preferably be chosen in consultation with and with the consent of the exporters, producers or importers concerned.

6.10.2 In cases where the authorities have limited their examination, as provided for in this paragraph, they shall nevertheless determine an individual margin of dumping for any exporter or producer not initially selected who submits the necessary information in time for that information to be considered during the course of the investigation, except where the number of exporters or producers is so large that individual examinations would be unduly burdensome to the authorities and prevent the timely completion of the investigation. Voluntary responses shall not be discouraged.

6.11 For the purposes of this Agreement, "interested parties" shall include:

- (i) an exporter or foreign producer or the importer of a product subject to investigation, or a trade or business association a majority of the members of which are producers, exporters or importers of such product;
- (ii) the government of the exporting Member; and
- (iii) a producer of the like product in the importing Member or a trade and business association a majority of the members of which produce the like product in the territory of the importing Member.

This list shall not preclude Members from allowing domestic or foreign parties other than those mentioned above to be included as interested parties.

6.12 The authorities shall provide opportunities for industrial users of the product under investigation, and for representative consumer organizations in cases where the product is commonly sold at the retail level, to provide information which is relevant to the investigation regarding dumping, injury and causality.

6.13 The authorities shall take due account of any difficulties experienced by interested parties, in particular small companies, in supplying information requested, and shall provide any assistance practicable.

6.14 The procedures set out above are not intended to prevent the authorities of a Member from proceeding expeditiously with regard to initiating an investigation, reaching preliminary or final determinations, whether affirmative or negative, or from applying provisional or final measures, in accordance with relevant provisions of this Agreement.

#### *Article 7*

##### *Provisional Measures*

7.1 Provisional measures may be applied only if:

- (i) an investigation has been initiated in accordance with the provisions of Article 5, a public notice has been given to that effect and interested parties have been given adequate opportunities to submit information and make comments;
- (ii) a preliminary affirmative determination has been made of dumping and consequent injury to a domestic industry; and
- (iii) the authorities concerned judge such measures necessary to prevent injury being caused during the investigation.

7.2 Provisional measures may take the form of a provisional duty or, preferably, a security - by cash deposit or bond - equal to the amount of the anti-dumping duty provisionally estimated, being not greater than the provisionally estimated margin of dumping. Withholding of appraisement is an appropriate provisional measure, provided that the normal duty and the estimated amount of the anti-dumping duty be indicated and as long as the withholding of appraisement is subject to the same conditions as other provisional measures.

7.3 Provisional measures shall not be applied sooner than 60 days from the date of initiation of the investigation.

7.4 The application of provisional measures shall be limited to as short a period as possible, not exceeding four months or, on decision of the authorities concerned, upon request by exporters representing a significant percentage of the trade involved, to a period not exceeding six months. When authorities, in the course of an investigation, examine whether a duty lower than the margin of dumping would be sufficient to remove injury, these periods may be six and nine months, respectively.

7.5 The relevant provisions of Article 9 shall be followed in the application of provisional measures.

#### *Article 8*

#### *Price Undertakings*

8.1 Proceedings may<sup>19</sup> be suspended or terminated without the imposition of provisional measures or anti-dumping duties upon receipt of satisfactory voluntary undertakings from any exporter to revise its prices or to cease exports to the area in question at dumped prices so that the authorities are satisfied that the injurious effect of the dumping is eliminated. Price increases under such undertakings shall not be higher than necessary to eliminate the margin of dumping. It is desirable that the price increases be less than the margin of dumping if such increases would be adequate to remove the injury to the domestic industry.

8.2 Price undertakings shall not be sought or accepted from exporters unless the authorities of the importing Member have made a preliminary affirmative determination of dumping and injury caused by such dumping.

8.3 Undertakings offered need not be accepted if the authorities consider their acceptance impractical, for example, if the number of actual or potential exporters is too great, or for other reasons, including reasons of general policy. Should the case arise and where practicable, the authorities shall provide to the exporter the reasons which have led them to consider acceptance of an undertaking as inappropriate, and shall, to the extent possible, give the exporter an opportunity to make comments thereon.

8.4 If an undertaking is accepted, the investigation of dumping and injury shall nevertheless be completed if the exporter so desires or the authorities so decide. In such a case, if a negative determination of dumping or injury is made, the undertaking shall automatically lapse, except in cases where such a determination is due in large part to the existence of a price undertaking. In such cases, the authorities may require that an undertaking be maintained for a reasonable period consistent with the provisions of this Agreement. In the event that an affirmative determination of dumping and injury is made, the undertaking shall continue consistent with its terms and the provisions of this Agreement.

8.5 Price undertakings may be suggested by the authorities of the importing Member, but no exporter shall be forced to enter into such undertakings. The fact that exporters do not offer such undertakings, or do not accept an invitation to do so, shall in no way prejudice the consideration of the case. However, the authorities are free to determine that a threat of injury is more likely to be realized if the dumped imports continue.

8.6 Authorities of an importing Member may require any exporter from whom an undertaking has been accepted to provide periodically information relevant to the fulfilment of such an undertaking and to permit verification of pertinent data. In case of violation of an undertaking, the authorities of the importing Member may take, under this Agreement in conformity with its provisions, expeditious actions which may constitute immediate application of provisional measures using the best information available. In such cases, definitive duties may be levied in accordance with this Agreement on products entered for consumption not more than 90 days before the application of such provisional measures, except that any such retroactive assessment shall not apply to imports entered before the violation of the undertaking.

<sup>19</sup> The word "may" shall not be interpreted to allow the simultaneous continuation of proceedings with the implementation of price undertakings except as provided in paragraph 4.

## Article 9

### Imposition and Collection of Anti-Dumping Duties

9.1 The decision whether or not to impose an anti-dumping duty in cases where all requirements for the imposition have been fulfilled, and the decision whether the amount of the anti-dumping duty to be imposed shall be the full margin of dumping or less, are decisions to be made by the authorities of the importing Member. It is desirable that the imposition be permissive in the territory of all Members, and that the duty be less than the margin if such lesser duty would be adequate to remove the injury to the domestic industry.

9.2 When an anti-dumping duty is imposed in respect of any product, such anti-dumping duty shall be collected in the appropriate amounts in each case, on a non-discriminatory basis on imports of such product from all sources found to be dumped and causing injury, except as to imports from those sources from which price undertakings under the terms of this Agreement have been accepted. The authorities shall name the supplier or suppliers of the product concerned. If, however, several suppliers from the same country are involved, and it is impracticable to name all these suppliers, the authorities may name the supplying country concerned. If several suppliers from more than one country are involved, the authorities may name either all the suppliers involved, or, if this is impracticable, all the supplying countries involved.

9.3 The amount of the anti-dumping duty shall not exceed the margin of dumping as established under Article 2.

9.3.1 When the amount of the anti-dumping duty is assessed on a retrospective basis, the determination of the final liability for payment of anti-dumping duties shall take place as soon as possible, normally within 12 months, and in no case more than 18 months, after the date on which a request for a final assessment of the amount of the anti-dumping duty has been made.<sup>20</sup> Any refund shall be made promptly and normally in not more than 90 days following the determination of final liability made pursuant to this sub-paragraph. In any case, where a refund is not made within 90 days, the authorities shall provide an explanation if so requested.

9.3.2 When the amount of the anti-dumping duty is assessed on a prospective basis, provision shall be made for a prompt refund, upon request, of any duty paid in excess of the margin of dumping. A refund of any such duty paid in excess of the actual margin of dumping shall normally take place within 12 months, and in no case more than 18 months, after the date on which a request for a refund, duly supported by evidence, has been made by an importer of the product subject to the anti-dumping duty. The refund authorized should normally be made within 90 days of the above-noted decision.

9.3.3 In determining whether and to what extent a reimbursement should be made when the export price is constructed in accordance with paragraph 3 of Article 2, authorities should take account of any change in normal value, any change in costs incurred between importation and resale, and any movement in the resale price which is duly reflected in subsequent selling prices, and should calculate the export price with no deduction for the amount of anti-dumping duties paid when conclusive evidence of the above is provided.

9.4 When the authorities have limited their examination in accordance with the second sentence of paragraph 10 of Article 6, any anti-dumping duty applied to imports from exporters or producers not included in the examination shall not exceed:

- (i) the weighted average margin of dumping established with respect to the selected exporters or producers or,
- (ii) where the liability for payment of anti-dumping duties is calculated on the basis of a prospective normal value, the difference between the weighted average normal value of the selected exporters or producers and the export prices of exporters or producers not individually examined,

provided that the authorities shall disregard for the purpose of this paragraph any zero and *de minimis* margins and margins established under the circumstances referred to in paragraph 8 of Article 6. The authorities shall apply individual duties or normal values to imports from any exporter or producer not included in the examination who has provided the necessary information during the course of the investigation, as provided for in subparagraph 10.2 of Article 6.

9.5 If a product is subject to anti-dumping duties in an importing Member, the authorities shall promptly carry out a review for the purpose of determining individual margins of dumping for any exporters or producers in the exporting country in question who have not exported the product to the importing Member during the period of investigation, provided that these exporters or producers can show that they are not related to any of the exporters or producers in the exporting country who are subject to the anti-dumping duties on the product. Such a review shall be initiated and carried out on an accelerated basis, compared to normal duty assessment and review proceedings in the importing Member. No anti-dumping duties shall be levied on imports from such exporters or producers while the review is being carried out. The authorities may, however, withhold appraisal and/or request guarantees to ensure that, should such a review result in a determination of dumping in respect of such producers or exporters, anti-dumping duties can be levied retroactively to the date of the initiation of the review.

## Article 10

### Retroactivity

10.1 Provisional measures and anti-dumping duties shall only be applied to products which enter for consumption after the time when the decision taken under paragraph 1 of Article 7 and paragraph 1 of Article 9, respectively, enters into force, subject to the exceptions set out in this Article.

10.2 Where a final determination of injury (but not of a threat thereof or of a material retardation of the establishment of an industry) is made or, in the case of a final determination of a threat of injury, where the effect of the dumped imports would, in the absence of the provisional measures, have led to a determination of injury, anti-dumping duties may be levied retroactively for the period for which provisional measures, if any, have been applied.

10.3 If the definitive anti-dumping duty is higher than the provisional duty paid or payable, or the amount estimated for the purpose of the security, the difference shall not be collected. If the definitive duty is lower than the provisional duty paid or payable, or the amount estimated for the purpose of the security, the difference shall be reimbursed or the duty recalculated, as the case may be.

<sup>20</sup> It is understood that the observance of the time-limits mentioned in this subparagraph and in subparagraph 3.2 may not be possible where the product in question is subject to judicial review proceedings.

10.4 Except as provided in paragraph 2, where a determination of threat of injury or material retardation is made (but no injury has yet occurred) a definitive anti-dumping duty may be imposed only from the date of the determination of threat of injury or material retardation, and any cash deposit made during the period of the application of provisional measures shall be refunded and any bonds released in an expeditious manner.

10.5 Where a final determination is negative, any cash deposit made during the period of the application of provisional measures shall be refunded and any bonds released in an expeditious manner.

10.6 A definitive anti-dumping duty may be levied on products which were entered for consumption not more than 90 days prior to the date of application of provisional measures, when the authorities determine for the dumped product in question that:

- (i) there is a history of dumping which caused injury or that the importer was, or should have been, aware that the exporter practises dumping and that such dumping would cause injury, and
- (ii) the injury is caused by massive dumped imports of a product in a relatively short time which in light of the timing and the volume of the dumped imports and other circumstances (such as a rapid build-up of inventories of the imported product) is likely to seriously undermine the remedial effect of the definitive anti-dumping duty to be applied, provided that the importers concerned have been given an opportunity to comment.

10.7 The authorities may, after initiating an investigation, take such measures as the withholding of appraisal or assessment as may be necessary to collect anti-dumping duties retroactively, as provided for in paragraph 6, once they have sufficient evidence that the conditions set forth in that paragraph are satisfied.

10.8 No duties shall be levied retroactively pursuant to paragraph 6 on products entered for consumption prior to the date of initiation of the investigation.

#### Article 11

##### *Duration and Review of Anti-Dumping Duties and Price Undertakings*

11.1 An anti-dumping duty shall remain in force only as long as and to the extent necessary to counteract dumping which is causing injury.

11.2 The authorities shall review the need for the continued imposition of the duty, where warranted, on their own initiative or, provided that a reasonable period of time has elapsed since the imposition of the definitive anti-dumping duty, upon request by any interested party which submits positive information substantiating the need for a review.<sup>21</sup> Interested parties shall have the right to request the authorities to examine whether the continued imposition of the duty is necessary to offset dumping, whether the injury would be likely to continue or recur if the duty were removed or varied, or both. If, as a result of the review under this paragraph, the authorities determine that the anti-dumping duty is no longer warranted, it shall be terminated immediately.

<sup>21</sup> A determination of final liability for payment of anti-dumping duties, as provided for in paragraph 3 of Article 9, does not by itself constitute a review within the meaning of this Article.

11.3 Notwithstanding the provisions of paragraphs 1 and 2, any definitive anti-dumping duty shall be terminated on a date not later than five years from its imposition (or from the date of the most recent review under paragraph 2 if that review has covered both dumping and injury, or under this paragraph), unless the authorities determine, in a review initiated before that date on their own initiative or upon a duly substantiated request made by or on behalf of the domestic industry within a reasonable period of time prior to that date, that the expiry of the duty would be likely to lead to continuation or recurrence of dumping and injury.<sup>22</sup> The duty may remain in force pending the outcome of such a review.

11.4 The provisions of Article 6 regarding evidence and procedure shall apply to any review carried out under this Article. Any such review shall be carried out expeditiously and shall normally be concluded within 12 months of the date of initiation of the review.

11.5 The provisions of this Article shall apply *mutatis mutandis* to price undertakings accepted under Article 8.

#### Article 12

##### *Public Notice and Explanation of Determinations*

12.1 When the authorities are satisfied that there is sufficient evidence to justify the initiation of an anti-dumping investigation pursuant to Article 5, the Member or Members the products of which are subject to such investigation and other interested parties known to the investigating authorities to have an interest therein shall be notified and a public notice shall be given.

12.1.1 A public notice of the initiation of an investigation shall contain, or otherwise make available through a separate report<sup>23</sup>, adequate information on the following:

- (i) the name of the exporting country or countries and the product involved;
- (ii) the date of initiation of the investigation;
- (iii) the basis on which dumping is alleged in the application;
- (iv) a summary of the factors on which the allegation of injury is based;
- (v) the address to which representations by interested parties should be directed;
- (vi) the time-limits allowed to interested parties for making their views known.

12.2 Public notice shall be given of any preliminary or final determination, whether affirmative or negative, of any decision to accept an undertaking pursuant to Article 8, of the termination of such an undertaking, and of the termination of a definitive anti-dumping duty. Each such notice shall set forth, or otherwise make available through a separate report, in sufficient detail the findings and conclusions reached on all issues of fact and law considered material by the investigating authorities. All such notices and reports shall be forwarded to the Member or Members the products of which are

<sup>22</sup> When the amount of the anti-dumping duty is assessed on a retrospective basis, a finding in the most recent assessment proceeding under subparagraph 3.1 of Article 9 that no duty is to be levied shall not by itself require the authorities to terminate the definitive duty.

<sup>23</sup> Where authorities provide information and explanations under the provisions of this Article in a separate report, they shall ensure that such report is readily available to the public.

subject to such determination or undertaking and to other interested parties known to have an interest therein.

12.2.1

A public notice of the imposition of provisional measures shall set forth, or otherwise make available through a separate report, sufficiently detailed explanations for the preliminary determinations on dumping and injury and shall refer to the matters of fact and law which have led to arguments being accepted or rejected. Such a notice or report shall, due regard being paid to the requirement for the protection of confidential information, contain in particular:

- (i) the names of the suppliers, or when this is impracticable, the supplying countries involved;
- (ii) a description of the product which is sufficient for customs purposes;
- (iii) the margins of dumping established and a full explanation of the reasons for the methodology used in the establishment and comparison of the export price and the normal value under Article 2;
- (iv) considerations relevant to the injury determination as set out in Article 3;
- (v) the main reasons leading to the determination.

12.2.2

A public notice of conclusion or suspension of an investigation in the case of an affirmative determination providing for the imposition of a definitive duty or the acceptance of a price undertaking shall contain, or otherwise make available through a separate report, all relevant information on the matters of fact and law and reasons which have led to the imposition of final measures or the acceptance of a price undertaking, due regard being paid to the requirement for the protection of confidential information. In particular, the notice or report shall contain the information described in subparagraph 2.1, as well as the reasons for the acceptance or rejection of relevant arguments or claims made by the exporters and importers, and the basis for any decision made under subparagraph 10.2 of Article 6.

12.2.3

A public notice of the termination or suspension of an investigation following the acceptance of an undertaking pursuant to Article 8 shall include, or otherwise make available through a separate report, the non-confidential part of this undertaking.

12.3 The provisions of this Article shall apply *mutatis mutandis* to the initiation and completion of reviews pursuant to Article 11 and to decisions under Article 10 to apply duties retroactively.

#### Article 13

##### Judicial Review

Each Member whose national legislation contains provisions on anti-dumping measures shall maintain judicial, arbitral or administrative tribunals or procedures for the purpose, *inter alia*, of the prompt review of administrative actions relating to final determinations and reviews of determinations within the meaning of Article 11. Such tribunals or procedures shall be independent of the authorities responsible for the determination or review in question.

#### Article 14

##### Anti-Dumping Action on Behalf of a Third Country

14.1 An application for anti-dumping action on behalf of a third country shall be made by the authorities of the third country requesting action.

14.2 Such an application shall be supported by price information to show that the imports are being dumped and by detailed information to show that the alleged dumping is causing injury to the domestic industry concerned in the third country. The government of the third country shall afford all assistance to the authorities of the importing country to obtain any further information which the latter may require.

14.3 In considering such an application, the authorities of the importing country shall consider the effects of the alleged dumping on the industry concerned as a whole in the third country; that is to say, the injury shall not be assessed in relation only to the effect of the alleged dumping on the industry's exports to the importing country or even on the industry's total exports.

14.4 The decision whether or not to proceed with a case shall rest with the importing country. If the importing country decides that it is prepared to take action, the initiation of the approach to the Council for Trade in Goods seeking its approval for such action shall rest with the importing country.

#### Article 15

##### Developing Country Members

It is recognized that special regard must be given by developed country Members to the special situation of developing country Members when considering the application of anti-dumping measures under this Agreement. Possibilities of constructive remedies provided for by this Agreement shall be explored before applying anti-dumping duties where they would affect the essential interests of developing country Members.

#### PART II

#### Article 16

##### Committee on Anti-Dumping Practices

16.1 There is hereby established a Committee on Anti-Dumping Practices (referred to in this Agreement as the "Committee") composed of representatives from each of the Members. The Committee shall elect its own Chairman and shall meet not less than twice a year and otherwise as envisaged by relevant provisions of this Agreement at the request of any Member. The Committee shall carry out responsibilities as assigned to it under this Agreement or by the Members and it shall afford Members the opportunity of consulting on any matters relating to the operation of the Agreement or the furtherance of its objectives. The WTO Secretariat shall act as the secretariat to the Committee.

16.2 The Committee may set up subsidiary bodies as appropriate.

16.3 In carrying out their functions, the Committee and any subsidiary bodies may consult with and seek information from any source they deem appropriate. However, before the Committee or a

subsidiary body seeks such information from a source within the jurisdiction of a Member, it shall inform the Member involved. It shall obtain the consent of the Member and any firm to be consulted.

16.4 Members shall report without delay to the Committee all preliminary or final anti-dumping actions taken. Such reports shall be available in the Secretariat for inspection by other Members. Members shall also submit, on a semi-annual basis, reports of any anti-dumping actions taken within the preceding six months. The semi-annual reports shall be submitted on an agreed standard form.

16.5 Each Member shall notify the Committee (a) which of its authorities are competent to initiate and conduct investigations referred to in Article 5 and (b) its domestic procedures governing the initiation and conduct of such investigations.

#### *Article 17*

##### *Consultation and Dispute Settlement*

17.1 Except as otherwise provided herein, the Dispute Settlement Understanding is applicable to consultations and the settlement of disputes under this Agreement.

17.2 Each Member shall afford sympathetic consideration to, and shall afford adequate opportunity for consultation regarding, representations made by another Member with respect to any matter affecting the operation of this Agreement.

17.3 If any Member considers that any benefit accruing to it, directly or indirectly, under this Agreement is being nullified or impaired, or that the achievement of any objective is being impeded, by another Member or Members, it may, with a view to reaching a mutually satisfactory resolution of the matter, request in writing consultations with the Member or Members in question. Each Member shall afford sympathetic consideration to any request from another Member for consultation.

17.4 If the Member that requested consultations considers that the consultations pursuant to paragraph 3 have failed to achieve a mutually agreed solution, and if final action has been taken by the administering authorities of the importing Member to levy definitive anti-dumping duties or to accept price undertakings, it may refer the matter to the Dispute Settlement Body ("DSB"). When a provisional measure has a significant impact and the Member that requested consultations considers that the measure was taken contrary to the provisions of paragraph 1 of Article 7, that Member may also refer such matter to the DSB.

17.5 The DSB shall, at the request of the complaining party, establish a panel to examine the matter based upon:

- (i) a written statement of the Member making the request indicating how a benefit accruing to it, directly or indirectly, under this Agreement has been nullified or impaired, or that the achieving of the objectives of the Agreement is being impeded, and
- (ii) the facts made available in conformity with appropriate domestic procedures to the authorities of the importing Member.

17.6 In examining the matter referred to in paragraph 5:

- (i) in its assessment of the facts of the matter, the panel shall determine whether the authorities' establishment of the facts was proper and whether their evaluation of those facts was unbiased and objective. If the establishment of the facts was proper

and the evaluation was unbiased and objective, even though the panel might have reached a different conclusion, the evaluation shall not be overturned;

- (ii) the panel shall interpret the relevant provisions of the Agreement in accordance with customary rules of interpretation of public international law. Where the panel finds that a relevant provision of the Agreement admits of more than one permissible interpretation, the panel shall find the authorities' measure to be in conformity with the Agreement if it rests upon one of those permissible interpretations.

17.7 Confidential information provided to the panel shall not be disclosed without formal authorization from the person, body or authority providing such information. Where such information is requested from the panel but release of such information by the panel is not authorized, a non-confidential summary of the information, authorized by the person, body or authority providing the information, shall be provided.

#### PART III

#### *Article 18*

##### *Final Provisions*

18.1 No specific action against dumping of exports from another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement.<sup>24</sup>

18.2 Reservations may not be entered in respect of any of the provisions of this Agreement without the consent of the other Members.

18.3 Subject to subparagraphs 3.1 and 3.2, the provisions of this Agreement shall apply to investigations, and reviews of existing measures, initiated pursuant to applications which have been made on or after the date of entry into force for a Member of the WTO Agreement.

18.3.1 With respect to the calculation of margins of dumping in refund procedures under paragraph 3 of Article 9, the rules used in the most recent determination or review of dumping shall apply.

18.3.2 For the purposes of paragraph 3 of Article 11, existing anti-dumping measures shall be deemed to be imposed on a date not later than the date of entry into force for a Member of the WTO Agreement, except in cases in which the domestic legislation of a Member in force on that date already included a clause of the type provided for in that paragraph.

18.4 Each Member shall take all necessary steps, of a general or particular character, to ensure, not later than the date of entry into force of the WTO Agreement for it, the conformity of its laws, regulations and administrative procedures with the provisions of this Agreement as they may apply for the Member in question.

18.5 Each Member shall inform the Committee of any changes in its laws and regulations relevant to this Agreement and in the administration of such laws and regulations.

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<sup>24</sup> This is not intended to preclude action under other relevant provisions of GATT 1994, as appropriate.

18.6 The Committee shall review annually the implementation and operation of this Agreement taking into account the objectives thereof. The Committee shall inform annually the Council for Trade in Goods of developments during the period covered by such reviews.

18.7 The Annexes to this Agreement constitute an integral part thereof.

#### ANNEX I

#### PROCEDURES FOR ON-THE-SPOT INVESTIGATIONS PURSUANT TO PARAGRAPH 7 OF ARTICLE 6

1. Upon initiation of an investigation, the authorities of the exporting Member and the firms known to be concerned should be informed of the intention to carry out on-the-spot investigations.
2. If in exceptional circumstances it is intended to include non-governmental experts in the investigating team, the firms and the authorities of the exporting Member should be so informed. Such non-governmental experts should be subject to effective sanctions for breach of confidentiality requirements.
3. It should be standard practice to obtain explicit agreement of the firms concerned in the exporting Member before the visit is finally scheduled.
4. As soon as the agreement of the firms concerned has been obtained, the investigating authorities should notify the authorities of the exporting Member of the names and addresses of the firms to be visited and the dates agreed.
5. Sufficient advance notice should be given to the firms in question before the visit is made.
6. Visits to explain the questionnaire should only be made at the request of an exporting firm. Such a visit may only be made if (a) the authorities of the importing Member notify the representatives of the Member in question and (b) the latter do not object to the visit.
7. As the main purpose of the on-the-spot investigation is to verify information provided or to obtain further details, it should be carried out after the response to the questionnaire has been received unless the firm agrees to the contrary and the government of the exporting Member is informed by the investigating authorities of the anticipated visit and does not object to it; further, it should be standard practice prior to the visit to advise the firms concerned of the general nature of the information to be verified and of any further information which needs to be provided, though this should not preclude requests to be made on the spot for further details to be provided in the light of information obtained.
8. Enquiries or questions put by the authorities or firms of the exporting Members and essential to a successful on-the-spot investigation should, whenever possible, be answered before the visit is made.

#### ANNEX II

#### BEST INFORMATION AVAILABLE IN TERMS OF PARAGRAPH 8 OF ARTICLE 6

1. As soon as possible after the initiation of the investigation, the investigating authorities should specify in detail the information required from any interested party, and the manner in which that information should be structured by the interested party in its response. The authorities should also ensure that the party is aware that if information is not supplied within a reasonable time, the

authorities will be free to make determinations on the basis of the facts available, including those contained in the application for the initiation of the investigation by the domestic industry.

2. The authorities may also request that an interested party provide its response in a particular medium (e.g. computer tape) or computer language. Where such a request is made, the authorities should consider the reasonable ability of the interested party to respond in the preferred medium or computer language, and should not request the party to use for its response a computer system other than that used by the party. The authority should not maintain a request for a computerized response if the interested party does not maintain computerized accounts and if presenting the response as requested would result in an unreasonable extra burden on the interested party, e.g. it would entail unreasonable additional cost and trouble. The authorities should not maintain a request for a response in a particular medium or computer language if the interested party does not maintain its computerized accounts in such medium or computer language and if presenting the response as requested would result in an unreasonable extra burden on the interested party, e.g. it would entail unreasonable additional cost and trouble.
3. All information which is verifiable, which is appropriately submitted so that it can be used in the investigation without undue difficulties, which is supplied in a timely fashion, and, where applicable, which is supplied in a medium or computer language requested by the authorities, should be taken into account when determinations are made. If a party does not respond in the preferred medium or computer language but the authorities find that the circumstances set out in paragraph 2 have been satisfied, the failure to respond in the preferred medium or computer language should not be considered to significantly impede the investigation.
4. Where the authorities do not have the ability to process information if provided in a particular medium (e.g. computer tape), the information should be supplied in the form of written material or any other form acceptable to the authorities.
5. Even though the information provided may not be ideal in all respects, this should not justify the authorities from disregarding it, provided the interested party has acted to the best of its ability.
6. If evidence or information is not accepted, the supplying party should be informed forthwith of the reasons therefor, and should have an opportunity to provide further explanations within a reasonable period, due account being taken of the time-limits of the investigation. If the explanations are considered by the authorities as not being satisfactory, the reasons for the rejection of such evidence or information should be given in any published determinations.
7. If the authorities have to base their findings, including those with respect to normal value, on information from a secondary source, including the information supplied in the application for the initiation of the investigation, they should do so with special circumspection. In such cases, the authorities should, where practicable, check the information from other independent sources at their disposal, such as published price lists, official import statistics and customs returns, and from the information obtained from other interested parties during the investigation. It is clear, however, that if an interested party does not cooperate and thus relevant information is being withheld from the authorities, this situation could lead to a result which is less favourable to the party than if the party did cooperate.

**Agreement on Subsidies and Countervailing  
Measures, 1994**

## AGREEMENT ON SUBSIDIES AND COUNTERVAILING MEASURES

*Members hereby agree as follows:*

### PART I: GENERAL PROVISIONS

#### *Article 1*

##### *Definition of a Subsidy*

1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:

- (a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where:
- (i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);
  - (ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits)<sup>1</sup>;
  - (iii) a government provides goods or services other than general infrastructure, or purchases goods;
  - (iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments;

or

(a)(2) there is any form of income or price support in the sense of Article XVI of GATT 1994;

and

(b) a benefit is thereby conferred.

1.2 A subsidy as defined in paragraph 1 shall be subject to the provisions of Part II or shall be subject to the provisions of Part III or V only if such a subsidy is specific in accordance with the provisions of Article 2.

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<sup>1</sup>In accordance with the provisions of Article XVI of GATT 1994 (Note to Article XVI) and the provisions of Annexes I through III of this Agreement, the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy.

#### *Article 2*

##### *Specificity*

2.1 In order to determine whether a subsidy, as defined in paragraph 1 of Article 1, is specific to an enterprise or industry or group of enterprises or industries (referred to in this Agreement as "certain enterprises") within the jurisdiction of the granting authority, the following principles shall apply:

- (a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific.
  - (b) Where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions<sup>2</sup> governing the eligibility for, and the amount of, a subsidy, specificity shall not exist, provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to. The criteria or conditions must be clearly spelled out in law, regulation, or other official document, so as to be capable of verification.
  - (c) If, notwithstanding any appearance of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific, other factors may be considered. Such factors are: use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy.<sup>3</sup> In applying this subparagraph, account shall be taken of the extent of diversification of economic activities within the jurisdiction of the granting authority, as well as of the length of time during which the subsidy programme has been in operation.
- 2.2 A subsidy which is limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority shall be specific. It is understood that the setting or change of generally applicable tax rates by all levels of government entitled to do so shall not be deemed to be a specific subsidy for the purposes of this Agreement.
- 2.3 Any subsidy falling under the provisions of Article 3 shall be deemed to be specific.
- 2.4 Any determination of specificity under the provisions of this Article shall be clearly substantiated on the basis of positive evidence.

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<sup>2</sup>Objective criteria or conditions, as used herein, mean criteria or conditions which are neutral, which do not favour certain enterprises over others, and which are economic in nature and horizontal in application, such as number of employees or size of enterprise.

<sup>3</sup>In this regard, in particular, information on the frequency with which applications for a subsidy are refused or approved and the reasons for such decisions shall be considered.

## PART II: PROHIBITED SUBSIDIES

*Article 3**Prohibition*

3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

- (a) subsidies contingent, in law or in fact<sup>4</sup>, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex F;
  - (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.
- 3.2 A Member shall neither grant nor maintain subsidies referred to in paragraph 1.

*Article 4**Remedies*

4.1 Whenever a Member has reason to believe that a prohibited subsidy is being granted or maintained by another Member, such Member may request consultations with such other Member.

4.2 A request for consultations under paragraph 1 shall include a statement of available evidence with regard to the existence and nature of the subsidy in question.

4.3 Upon request for consultations under paragraph 1, the Member believed to be granting or maintaining the subsidy in question shall enter into such consultations as quickly as possible. The purpose of the consultations shall be to clarify the facts of the situation and to arrive at a mutually agreed solution.

4.4 If no mutually agreed solution has been reached within 30 days<sup>6</sup> of the request for consultations, any Member party to such consultations may refer the matter to the Dispute Settlement Body ("DSB") for the immediate establishment of a panel, unless the DSB decides by consensus not to establish a panel.

4.5 Upon its establishment, the panel may request the assistance of the Permanent Group of Experts<sup>7</sup> (referred to in this Agreement as the "PGE") with regard to whether the measure in question is a prohibited subsidy. If so requested, the PGE shall immediately review the evidence with regard to

<sup>4</sup>This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.

<sup>5</sup>Measures referred to in Annex 1 as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.

<sup>6</sup>Any time-periods mentioned in this Article may be extended by mutual agreement.

<sup>7</sup>As established in Article 24.

the existence and nature of the measure in question and shall provide an opportunity for the Member applying or maintaining the measure to demonstrate that the measure in question is not a prohibited subsidy. The PGE shall report its conclusions to the panel within a time-limit determined by the panel. The PGE's conclusions on the issue of whether or not the measure in question is a prohibited subsidy shall be accepted by the panel without modification.

4.6 The panel shall submit its final report to the parties to the dispute. The report shall be circulated to all Members within 90 days of the date of the composition and the establishment of the panel's terms of reference.

4.7 If the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the subsidy without delay. In this regard, the panel shall specify in its recommendation the time-period within which the measure must be withdrawn.

4.8 Within 30 days of the issuance of the panel's report to all Members, the report shall be adopted by the DSB unless one of the parties to the dispute formally notifies the DSB of its decision to appeal or the DSB decides by consensus not to adopt the report.

4.9 Where a panel report is appealed, the Appellate Body shall issue its decision within 30 days from the date when the party to the dispute formally notifies its intention to appeal. When the Appellate Body considers that it cannot provide its report within 30 days, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will submit its report. In no case shall the proceedings exceed 60 days. The appellate report shall be adopted by the DSB and unconditionally accepted by the parties to the dispute unless the DSB decides by consensus not to adopt the appellate report within 20 days following its issuance to the Members.<sup>8</sup>

4.10 In the event the recommendation of the DSB is not followed within the time-period specified by the panel, which shall commence from the date of adoption of the panel's report or the Appellate Body's report, the DSB shall grant authorization to the complaining Member to take appropriate countermeasures, unless the DSB decides by consensus to reject the request.

4.11 In the event a party to the dispute requests arbitration under paragraph 6 of Article 22 of the Dispute Settlement Understanding ("DSU"), the arbitrator shall determine whether the countermeasures are appropriate.<sup>10</sup>

4.12 For purposes of disputes conducted pursuant to this Article, except for time-periods specifically prescribed in this Article, time-periods applicable under the DSU for the conduct of such disputes shall be half the time prescribed therein.

<sup>8</sup>If a meeting of the DSB is not scheduled during this period, such a meeting shall be held for this purpose.

<sup>9</sup>This expression is not meant to allow countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited.

<sup>10</sup>This expression is not meant to allow countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited.

## PART III: ACTIONABLE SUBSIDIES

*Article 5**Adverse Effects*

No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.:

- (a) injury to the domestic industry of another Member<sup>11</sup>;
- (b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994 in particular the benefits of concessions bound under Article II of GATT 1994<sup>12</sup>;
- (c) serious prejudice to the interests of another Member.<sup>13</sup>

This Article does not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture.

*Article 6**Serious Prejudice*

6.1 Serious prejudice in the sense of paragraph (c) of Article 5 shall be deemed to exist in the case of:

- (a) the total ad valorem subsidization<sup>14</sup> of a product exceeding 5 per cent<sup>15</sup>;
- (b) subsidies to cover operating losses sustained by an industry;
- (c) subsidies to cover operating losses sustained by an enterprise, other than one-time measures which are non-recurrent and cannot be repeated for that enterprise and which are given merely to provide time for the development of long-term solutions and to avoid acute social problems;

<sup>11</sup>The term "injury to the domestic industry" is used here in the same sense as it is used in Part V.

<sup>12</sup>The term "nullification or impairment" is used in this Agreement in the same sense as it is used in the relevant provisions of GATT 1994, and the existence of such nullification or impairment shall be established in accordance with the practice of application of these provisions.

<sup>13</sup>The term "serious prejudice to the interests of another Member" is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice.

<sup>14</sup>The total ad valorem subsidization shall be calculated in accordance with the provisions of Annex IV.

<sup>15</sup>Since it is anticipated that civil aircraft will be subject to specific multilateral rules, the threshold in this subparagraph does not apply to civil aircraft.

- (d) direct forgiveness of debt, i.e. forgiveness of government-held debt, and grants to cover debt repayment.<sup>16</sup>

6.2 Notwithstanding the provisions of paragraph 1, serious prejudice shall not be found if the subsidizing Member demonstrates that the subsidy in question has not resulted in any of the effects enumerated in paragraph 3.

6.3 Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply:

- (a) the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member;
- (b) the effect of the subsidy is to displace or impede the exports of a like product of another Member from a third country market;
- (c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market;
- (d) the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity<sup>17</sup> as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted.

6.4 For the purpose of paragraph 3(b), the displacement or impeding of exports shall include any case in which, subject to the provisions of paragraph 7, it has been demonstrated that there has been a change in relative shares of the market to the disadvantage of the non-subsidized like product (over an appropriately representative period sufficient to demonstrate clear trends in the development of the market for the product concerned, which, in normal circumstances, shall be at least one year). "Change in relative shares of the market" shall include any of the following situations: (a) there is an increase in the market share of the subsidized product; (b) the market share of the subsidized product remains constant in circumstances in which, in the absence of the subsidy, it would have declined; (c) the market share of the subsidized product declines, but at a slower rate than would have been the case in the absence of the subsidy.

6.5 For the purpose of paragraph 3(c), price undercutting shall include any case in which such price undercutting has been demonstrated through a comparison of prices of the subsidized product with prices of a non-subsidized like product supplied to the same market. The comparison shall be made at the same level of trade and at comparable times, due account being taken of any other factor affecting price comparability. However, if such a direct comparison is not possible, the existence of price undercutting may be demonstrated on the basis of export unit values.

6.6 Each Member in the market of which serious prejudice is alleged to have arisen shall, subject to the provisions of paragraph 3 of Annex V, make available to the parties to a dispute arising under Article 7, and to the panel established pursuant to paragraph 4 of Article 7, all relevant information

<sup>16</sup>Members recognize that where royalty-based financing for a civil aircraft programme is not being fully repaid due to the level of actual sales falling below the level of forecast sales, this does not in itself constitute serious prejudice for the purposes of this subparagraph.

<sup>17</sup>Unless other multilaterally agreed specific rules apply to the trade in the product or commodity in question.

that can be obtained as to the changes in market shares of the parties to the dispute as well as concerning prices of the products involved.

6.7 Displacement or impediment resulting in serious prejudice shall not arise under paragraph 3 where any of the following circumstances exist<sup>18</sup> during the relevant period:

- (a) prohibition or restriction on exports of the like product from the complaining Member or on imports from the complaining Member into the third country market concerned;
- (b) decision by an importing government operating a monopoly of trade or state trading in the product concerned to shift, for non-commercial reasons, imports from the complaining Member to another country or countries;
- (c) natural disasters, strikes, transport disruptions or other *force majeure* substantially affecting production, qualities, quantities or prices of the product available for export from the complaining Member;
- (d) existence of arrangements limiting exports from the complaining Member;
- (e) voluntary decrease in the availability for export of the product concerned from the complaining Member (including, *inter alia*, a situation where firms in the complaining Member have been autonomously reallocating exports of this product to new markets);
- (f) failure to conform to standards and other regulatory requirements in the importing country.

6.8 In the absence of circumstances referred to in paragraph 7, the existence of serious prejudice should be determined on the basis of the information submitted to or obtained by the panel, including information submitted in accordance with the provisions of Annex V.

6.9 This Article does not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture.

#### Article 7

##### Remedies

7.1 Except as provided in Article 13 of the Agreement on Agriculture, whenever a Member has reason to believe that any subsidy referred to in Article 1, granted or maintained by another Member, results in injury to its domestic industry, nullification or impairment or serious prejudice, such Member may request consultations with such other Member.

7.2 A request for consultations under paragraph 1 shall include a statement of available evidence with regard to (a) the existence and nature of the subsidy in question, and (b) the injury caused to the

domestic industry, or the nullification or impairment, or serious prejudice<sup>19</sup> caused to the interests of the Member requesting consultations.

7.3 Upon request for consultations under paragraph 1, the Member believed to be granting or maintaining the subsidy practice in question shall enter into such consultations as quickly as possible. The purpose of the consultations shall be to clarify the facts of the situation and to arrive at a mutually agreed solution.

7.4 If consultations do not result in a mutually agreed solution within 60 days<sup>20</sup>, any Member party to such consultations may refer the matter to the DSB for the establishment of a panel, unless the DSB decides by consensus not to establish a panel. The composition of the panel and its terms of reference shall be established within 15 days from the date when it is established.

7.5 The panel shall review the matter and shall submit its final report to the parties to the dispute. The report shall be circulated to all Members within 120 days of the date of the composition and establishment of the panel's terms of reference.

7.6 Within 30 days of the issuance of the panel's report to all Members, the report shall be adopted by the DSB<sup>21</sup> unless one of the parties to the dispute formally notifies the DSB of its decision to appeal or the DSB decides by consensus not to adopt the report.

7.7 Where a panel report is appealed, the Appellate Body shall issue its decision within 60 days from the date when the party to the dispute formally notifies its intention to appeal. When the Appellate Body considers that it cannot provide its report within 60 days, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will submit its report. In no case shall the proceedings exceed 90 days. The appellate report shall be adopted by the DSB and unconditionally accepted by the parties to the dispute unless the DSB decides by consensus not to adopt the appellate report within 20 days following its issuance to the Members.<sup>22</sup>

7.8 Where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy has resulted in adverse effects to the interests of another Member within the meaning of Article 5, the Member granting or maintaining such subsidy shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy.

7.9 In the event the Member has not taken appropriate steps to remove the adverse effects of the subsidy or withdraw the subsidy within six months from the date when the DSB adopts the panel report or the Appellate Body report, and in the absence of agreement on compensation, the DSB shall grant authorization to the complaining Member to take countermeasures, commensurate with the degree and nature of the adverse effects determined to exist, unless the DSB decides by consensus to reject the request.

<sup>19</sup>In the event that the request relates to a subsidy deemed to result in serious prejudice in terms of paragraph 1 of Article 6, the available evidence of serious prejudice may be limited to the available evidence as to whether the conditions of paragraph 1 of Article 6 have been met or not.

<sup>20</sup>Any time-periods mentioned in this Article may be extended by mutual agreement.

<sup>21</sup>If a meeting of the DSB is not scheduled during this period, such a meeting shall be held for this purpose.

<sup>22</sup>If a meeting of the DSB is not scheduled during this period, such a meeting shall be held for this purpose.

<sup>18</sup>The fact that certain circumstances are referred to in this paragraph does not, in itself, confer upon them any legal status in terms of either GATT 1994 or this Agreement. These circumstances must not be isolated, sporadic or otherwise insignificant.

7.10 In the event that a party to the dispute requests arbitration under paragraph 6 of Article 22 of the DSU, the arbitrator shall determine whether the countermeasures are commensurate with the degree and nature of the adverse effects determined to exist.

#### PART IV: NON-ACTIONABLE SUBSIDIES

##### Article 8

##### *Identification of Non-Actionable Subsidies*

8.1 The following subsidies shall be considered as non-actionable<sup>23</sup>:

- (a) subsidies which are not specific within the meaning of Article 2;
- (b) subsidies which are specific within the meaning of Article 2 but which meet all of the conditions provided for in paragraphs 2(a), 2(b) or 2(c) below.

8.2 Notwithstanding the provisions of Parts III and V, the following subsidies shall be non-actionable:

- (a) assistance for research activities conducted by firms or by higher education or research establishments on a contract basis with firms if:<sup>24, 25, 26</sup>
  - the assistance covers<sup>27</sup> not more than 75 per cent of the costs of industrial research<sup>28</sup> or 50 per cent of the costs of pre-competitive development activity<sup>29, 30</sup>;

<sup>23</sup>It is recognized that government assistance for various purposes is widely provided by Members and that the mere fact that such assistance may not qualify for non-actionable treatment under the provisions of this Article does not in itself restrict the ability of Members to provide such assistance.

<sup>24</sup>Since it is anticipated that civil aircraft will be subject to specific multilateral rules, the provisions of this subparagraph do not apply to that product.

<sup>25</sup>Not later than 18 months after the date of entry into force of the WTO Agreement, the Committee on Subsidies and Countervailing Measures provided for in Article 24 (referred to in this Agreement as "the Committee") shall review the operation of the provisions of subparagraph 2(a) with a view to making all necessary modifications to improve the operation of those provisions. In its consideration of possible modifications, the Committee shall carefully review the definitions of the categories set forth in this subparagraph in the light of the experience of Members in the operation of research programmes and the work in other relevant international institutions.

<sup>26</sup>The provisions of this Agreement do not apply to fundamental research activities independently conducted by higher education or research establishments. The term "fundamental research" means an enlargement of general scientific and technical knowledge not linked to industrial or commercial objectives.

<sup>27</sup>The allowable levels of non-actionable assistance referred to in this subparagraph shall be established by reference to the total eligible costs incurred over the duration of an individual project.

<sup>28</sup>The term "industrial research" means planned search or critical investigation aimed at discovery of new knowledge, with the objective that such knowledge may be useful in developing new products, processes or services, or in bringing about a significant improvement to existing products, processes or services.

<sup>29</sup>The term "pre-competitive development activity" means the translation of industrial research findings into a plan, blueprint or design for new, modified or improved products, processes or services whether intended for sale or use, including the creation of a first prototype which would not be capable of commercial use. It may further include the conceptual formulation and design of products, processes or services alternatives and initial demonstration or pilot projects, provided that these same projects

and provided that such assistance is limited exclusively to:

- (i) costs of personnel (researchers, technicians and other supporting staff employed exclusively in the research activity);
- (ii) costs of instruments, equipment, land and buildings used exclusively and permanently (except when disposed of on a commercial basis) for the research activity;
- (iii) costs of consultancy and equivalent services used exclusively for the research activity, including bought-in research, technical knowledge, patents, etc.;
- (iv) additional overhead costs incurred directly as a result of the research activity;
- (v) other running costs (such as those of materials, supplies and the like), incurred directly as a result of the research activity.

(b) assistance to disadvantaged regions within the territory of a Member given pursuant to a general framework of regional development<sup>31</sup> and non-specific (within the meaning of Article 2) within eligible regions provided that:

- (i) each disadvantaged region must be a clearly designated contiguous geographical area with a definable economic and administrative identity;
- (ii) the region is considered as disadvantaged on the basis of neutral and objective criteria<sup>32</sup>, indicating that the region's difficulties arise out of more than temporary circumstances; such criteria must be clearly spelled out in law, regulation, or other official document, so as to be capable of verification;
- (iii) the criteria shall include a measurement of economic development which shall be based on at least one of the following factors:
  - one of either income per capita or household income per capita, or GDP per capita, which must not be above 85 per cent of the average for the territory concerned;

cannot be converted or used for industrial application or commercial exploitation. It does not include routine or periodic alterations to existing products, production lines, manufacturing processes, services, and other on-going operations even though those alterations may represent improvements.

<sup>31</sup>In the case of programmes which span industrial research and pre-competitive development activity, the allowable level of non-actionable assistance shall not exceed the simple average of the allowable levels of non-actionable assistance applicable to the above two categories, calculated on the basis of all eligible costs as set forth in items (i) to (v) of this subparagraph.

<sup>32</sup>A "general framework of regional development" means that regional subsidy programmes are part of an internally consistent and generally applicable regional development policy and that regional development subsidies are not granted in isolated geographical points having no, or virtually no, influence on the development of a region.

<sup>33</sup>Neutral and objective criteria" means criteria which do not favour certain regions beyond what is appropriate for the elimination or reduction of regional disparities within the framework of the regional development policy. In this regard, regional subsidy programmes shall include ceilings on the amount of assistance which can be granted to each subsidized project. Such ceilings must be differentiated according to the different levels of development of assisted regions and must be expressed in terms of investment costs or cost of job creation. Within such ceilings, the distribution of assistance shall be sufficiently broad and even to avoid the predominant use of a subsidy by, or the granting of disproportionately large amounts of subsidy to, certain enterprises as provided for in Article 2.

- unemployment rate, which must be at least 110 per cent of the average for the territory concerned;
  - as measured over a three-year period; such measurement, however, may be a composite one and may include other factors.
- (c) assistance to promote adaptation of existing facilities<sup>33</sup> to new environmental requirements imposed by law and/or regulations which result in greater constraints and financial burden on firms, provided that the assistance:
- (i) is a one-time non-recurring measure; and
  - (ii) is limited to 20 per cent of the cost of adaptation; and
  - (iii) does not cover the cost of replacing and operating the assisted investment, which must be fully borne by firms; and
  - (iv) is directly linked to and proportionate to a firm's planned reduction of nuisances and pollution, and does not cover any manufacturing cost savings which may be achieved; and
  - (v) is available to all firms which can adopt the new equipment and/or production processes.

8.3 A subsidy programme for which the provisions of paragraph 2 are invoked shall be notified in advance of its implementation to the Committee in accordance with the provisions of Part VII. Any such notification shall be sufficiently precise to enable other Members to evaluate the consistency of the programme with the conditions and criteria provided for in the relevant provisions of paragraph 2. Members shall also provide the Committee with yearly updates of such notifications, in particular by supplying information on global expenditure for each programme, and on any modification of the programme. Other Members shall have the right to request information about individual cases of subsidization under a notified programme.<sup>34</sup>

8.4 Upon request of a Member, the Secretariat shall review a notification made pursuant to paragraph 3 and, where necessary, may require additional information from the subsidizing Member concerning the notified programme under review. The Secretariat shall report its findings to the Committee. The Committee shall, upon request, promptly review the findings of the Secretariat (or, if a review by the Secretariat has not been requested, the notification itself), with a view to determining whether the conditions and criteria laid down in paragraph 2 have not been met. The procedure provided for in this paragraph shall be completed at the latest at the first regular meeting of the Committee following the notification of a subsidy programme, provided that at least two months have elapsed between such notification and the regular meeting of the Committee. The review procedure described in this paragraph shall also apply, upon request, to substantial modifications of a programme notified in the yearly updates referred to in paragraph 3.

8.5 Upon the request of a Member, the determination by the Committee referred to in paragraph 4, or a failure by the Committee to make such a determination, as well as the violation, in individual cases,

<sup>33</sup>The term "existing facilities" means facilities which have been in operation for at least two years at the time when new environmental requirements are imposed.

<sup>34</sup>It is recognized that nothing in this notification provision requires the provision of confidential information, including confidential business information.

of the conditions set out in a notified programme, shall be submitted to binding arbitration. The arbitration body shall present its conclusions to the Members within 120 days from the date when the matter was referred to the arbitration body. Except as otherwise provided in this paragraph, the DSU shall apply to arbitrations conducted under this paragraph.

#### Article 9

##### *Consultations and Authorized Remedies*

9.1 If, in the course of implementation of a programme referred to in paragraph 2 of Article 8, notwithstanding the fact that the programme is consistent with the criteria laid down in that paragraph, a Member has reasons to believe that this programme has resulted in serious adverse effects to the domestic industry of that Member, such as to cause damage which would be difficult to repair, such Member may request consultations with the Member granting or maintaining the subsidy.

9.2 Upon request for consultations under paragraph 1, the Member granting or maintaining the subsidy programme in question shall enter into such consultations as quickly as possible. The purpose of the consultations shall be to clarify the facts of the situation and to arrive at a mutually acceptable solution.

9.3 If no mutually acceptable solution has been reached in consultations under paragraph 2 within 60 days of the request for such consultations, the requesting Member may refer the matter to the Committee.

9.4 Where a matter is referred to the Committee, the Committee shall immediately review the facts involved and the evidence of the effects referred to in paragraph 1. If the Committee determines that such effects exist, it may recommend to the subsidizing Member to modify this programme in such a way as to remove these effects. The Committee shall present its conclusions within 120 days from the date when the matter is referred to it under paragraph 3. In the event the recommendation is not followed within six months, the Committee shall authorize the requesting Member to take appropriate countermeasures commensurate with the nature and degree of the effects determined to exist.

## PART V: COUNTERVAILING MEASURES

## Article 10

*Application of Article VI of GATT 1994<sup>35</sup>*

Members shall take all necessary steps to ensure that the imposition of a countervailing duty<sup>36</sup> on any product of the territory of any Member imported into the territory of another Member is in accordance with the provisions of Article VI of GATT 1994 and the terms of this Agreement. Countervailing duties may only be imposed pursuant to investigations initiated<sup>37</sup> and conducted in accordance with the provisions of this Agreement and the Agreement on Agriculture.

## Article 11

*Initiation and Subsequent Investigation*

11.1 Except as provided in paragraph 6, an investigation to determine the existence, degree and effect of any alleged subsidy shall be initiated upon a written application by or on behalf of the domestic industry.

11.2 An application under paragraph 1 shall include sufficient evidence of the existence of (a) a subsidy and, if possible, its amount, (b) injury within the meaning of Article VI of GATT 1994 as interpreted by this Agreement, and (c) a causal link between the subsidized imports and the alleged injury. Simple assertion, unsubstantiated by relevant evidence, cannot be considered sufficient to meet the requirements of this paragraph. The application shall contain such information as is reasonably available to the applicant on the following:

- (i) the identity of the applicant and a description of the volume and value of the domestic production of the like product by the applicant. Where a written application is made on behalf of the domestic industry, the application shall identify the industry on behalf of which the application is made by a list of all known domestic producers of the like product (or associations of domestic producers of the like product) and, to the extent possible, a description of the volume and value of domestic production of the like product accounted for by such producers;

<sup>35</sup>The provisions of Part II or III may be invoked in parallel with the provisions of Part V; however, with regard to the effects of a particular subsidy in the domestic market of the importing Member, only one form of relief (either a countervailing duty, if the requirements of Part V are met, or a countermeasure under Articles 4 or 7) shall be available. The provisions of Parts III and V shall not be invoked regarding measures considered non-actionable in accordance with the provisions of Part IV. However, measures referred to in paragraph 1(a) of Article 8 may be investigated in order to determine whether or not they are specific within the meaning of Article 2. In addition, in the case of a subsidy referred to in paragraph 2 of Article 8 conferred pursuant to a programme which has not been notified in accordance with paragraph 3 of Article 8, the provisions of Part III or V may be invoked, but such subsidy shall be treated as non-actionable if it is found to conform to the standards set forth in paragraph 2 of Article 8.

<sup>36</sup>The term "countervailing duty" shall be understood to mean a special duty levied for the purpose of offsetting any subsidy bestowed directly or indirectly upon the manufacture, production or export of any merchandise, as provided for in paragraph 3 of Article VI of GATT 1994.

<sup>37</sup>The term "initiated" as used hereinafter means procedural action by which a Member formally commences an investigation as provided in Article 11.

- (ii) a complete description of the allegedly subsidized product, the names of the country or countries of origin or export in question, the identity of each known exporter or foreign producer and a list of known persons importing the product in question;
- (iii) evidence with regard to the existence, amount and nature of the subsidy in question;
- (iv) evidence that alleged injury to a domestic industry is caused by subsidized imports through the effects of the subsidies; this evidence includes information on the evolution of the volume of the allegedly subsidized imports, the effect of these imports on prices of the like product in the domestic market and the consequent impact of the imports on the domestic industry, as demonstrated by relevant factors and indices having a bearing on the state of the domestic industry, such as those listed in paragraphs 2 and 4 of Article 15.

11.3 The authorities shall review the accuracy and adequacy of the evidence provided in the application to determine whether the evidence is sufficient to justify the initiation of an investigation.

11.4 An investigation shall not be initiated pursuant to paragraph 1 unless the authorities have determined, on the basis of an examination of the degree of support for, or opposition to, the application expressed<sup>38</sup> by domestic producers of the like product, that the application has been made by or on behalf of the domestic industry.<sup>39</sup> The application shall be considered to have been made "by or on behalf of the domestic industry" if it is supported by those domestic producers whose collective output constitutes more than 50 per cent of the total production of the like product produced by that portion of the domestic industry expressing either support for or opposition to the application. However, no investigation shall be initiated when domestic producers expressly supporting the application account for less than 25 per cent of total production of the like product produced by the domestic industry.

11.5 The authorities shall avoid, unless a decision has been made to initiate an investigation, any publicizing of the application for the initiation of an investigation.

11.6 If, in special circumstances, the authorities concerned decide to initiate an investigation without having received a written application by or on behalf of a domestic industry for the initiation of such investigation, they shall proceed only if they have sufficient evidence of the existence of a subsidy, injury and causal link, as described in paragraph 2, to justify the initiation of an investigation.

11.7 The evidence of both subsidy and injury shall be considered simultaneously (a) in the decision whether or not to initiate an investigation and (b) thereafter, during the course of the investigation, starting on a date not later than the earliest date on which in accordance with the provisions of this Agreement provisional measures may be applied.

11.8 In cases where products are not imported directly from the country of origin but are exported to the importing Member from an intermediate country, the provisions of this Agreement shall be fully applicable and the transaction or transactions shall, for the purposes of this Agreement, be regarded as having taken place between the country of origin and the importing Member.

11.9 An application under paragraph 1 shall be rejected and an investigation shall be terminated promptly as soon as the authorities concerned are satisfied that there is not sufficient evidence of either

<sup>38</sup>In the case of fragmented industries involving an exceptionally large number of producers, authorities may determine support and opposition by using statistically valid sampling techniques.

<sup>39</sup>Members are aware that in the territory of certain Members employees of domestic producers of the like product or representatives of those employees may make or support an application for an investigation under paragraph 1.

subsidization or of injury to justify proceeding with the case. There shall be immediate termination in cases where the amount of a subsidy is *de minimis*, or where the volume of subsidized imports, actual or potential, or the injury, is negligible. For the purpose of this paragraph, the amount of the subsidy shall be considered to be *de minimis* if the subsidy is less than 1 per cent *ad valorem*.

11.10 An investigation shall not hinder the procedures of customs clearance.

11.11 Investigations shall, except in special circumstances, be concluded within one year, and in no case more than 18 months, after their initiation.

## Article 12

### Evidence

12.1 Interested Members and all interested parties in a countervailing duty investigation shall be given notice of the information which the authorities require and ample opportunity to present in writing all evidence which they consider relevant in respect of the investigation in question.

12.1.1 Exporters, foreign producers or interested Members receiving questionnaires used in a countervailing duty investigation shall be given at least 30 days for reply.<sup>40</sup> Due consideration should be given to any request for an extension of the 30-day period and, upon cause shown, such an extension should be granted whenever practicable.

12.1.2 Subject to the requirement to protect confidential information, evidence presented in writing by one interested Member or interested party shall be made available promptly to other interested Members or interested parties participating in the investigation.

12.1.3 As soon as an investigation has been initiated, the authorities shall provide the full text of the written application received under paragraph 1 of Article 11 to the known exporters<sup>41</sup> and to the authorities of the exporting Member and shall make it available, upon request, to other interested parties involved. Due regard shall be paid to the protection of confidential information, as provided for in paragraph 4.

12.2 Interested Members and interested parties also shall have the right, upon justification, to present information orally. Where such information is provided orally, the interested Members and interested parties subsequently shall be required to reduce such submissions to writing. Any decision of the investigating authorities can only be based on such information and arguments as were on the written record of this authority and which were available to interested Members and interested parties participating in the investigation, due account having been given to the need to protect confidential information.

12.3 The authorities shall whenever practicable provide timely opportunities for all interested Members and interested parties to see all information that is relevant to the presentation of their cases, that is

<sup>40</sup>As a general rule, the time-limit for exporters shall be counted from the date of receipt of the questionnaire, which for this purpose shall be deemed to have been received one week from the date on which it was sent to the respondent or transmitted to the appropriate diplomatic representatives of the exporting Member or, in the case of a separate customs territory Member of the WTO, an official representative of the exporting territory.

<sup>41</sup>It being understood that where the number of exporters involved is particularly high, the full text of the application should instead be provided only to the authorities of the exporting Member or to the relevant trade association who then should forward copies to the exporters concerned.

not confidential as defined in paragraph 4, and that is used by the authorities in a countervailing duty investigation, and to prepare presentations on the basis of this information.

12.4 Any information which is by nature confidential (for example, because its disclosure would be of significant competitive advantage to a competitor or because its disclosure would have a significantly adverse effect upon a person supplying the information or upon a person from whom the supplier acquired the information), or which is provided on a confidential basis by parties to an investigation shall, upon good cause shown, be treated as such by the authorities. Such information shall not be disclosed without specific permission of the party submitting it.<sup>42</sup>

12.4.1 The authorities shall require interested Members or interested parties providing confidential information to furnish non-confidential summaries thereof. These summaries shall be in sufficient detail to permit a reasonable understanding of the substance of the information submitted in confidence. In exceptional circumstances, such Members or parties may indicate that such information is not susceptible of summary. In such exceptional circumstances, a statement of the reasons why summarization is not possible must be provided.

12.4.2 If the authorities find that a request for confidentiality is not warranted and if the supplier of the information is either unwilling to make the information public or to authorize its disclosure in generalized or summary form, the authorities may disregard such information unless it can be demonstrated to their satisfaction from appropriate sources that the information is correct.<sup>43</sup>

12.5 Except in circumstances provided for in paragraph 7, the authorities shall during the course of an investigation satisfy themselves as to the accuracy of the information supplied by interested Members or interested parties upon which their findings are based.

12.6 The investigating authorities may carry out investigations in the territory of other Members as required, provided that they have notified in good time the Member in question and unless that Member objects to the investigation. Further, the investigating authorities may carry out investigations on the premises of a firm and may examine the records of a firm if (a) the firm so agrees and (b) the Member in question is notified and does not object. The procedures set forth in Annex VI shall apply to investigations on the premises of a firm. Subject to the requirement to protect confidential information, the authorities shall make the results of any such investigations available, or shall provide disclosure thereof pursuant to paragraph 8, to the firms to which they pertain and may make such results available to the applicants.

12.7 In cases in which any interested Member or interested party refuses access to, or otherwise does not provide, necessary information within a reasonable period or significantly impedes the investigation, preliminary and final determinations, affirmative or negative, may be made on the basis of the facts available.

12.8 The authorities shall, before a final determination is made, inform all interested Members and interested parties of the essential facts under consideration which form the basis for the decision whether to apply definitive measures. Such disclosure should take place in sufficient time for the parties to defend their interests.

<sup>42</sup>Members are aware that in the territory of certain Members disclosure pursuant to a narrowly-drawn protective order may be required.

<sup>43</sup>Members agree that requests for confidentiality should not be arbitrarily rejected. Members further agree that the investigating authority may request the waiving of confidentiality only regarding information relevant to the proceedings.

12.9 For the purposes of this Agreement, "interested parties" shall include:

- (i) an exporter or foreign producer or the importer of a product subject to investigation, or a trade or business association a majority of the members of which are producers, exporters or importers of such product; and
- (ii) a producer of the like product in the importing Member or a trade and business association a majority of the members of which produce the like product in the territory of the importing Member.

This list shall not preclude Members from allowing domestic or foreign parties other than those mentioned above to be included as interested parties.

12.10 The authorities shall provide opportunities for industrial users of the product under investigation, and for representative consumer organizations in cases where the product is commonly sold at the retail level, to provide information which is relevant to the investigation regarding subsidization, injury and causality.

12.11 The authorities shall take due account of any difficulties experienced by interested parties, in particular small companies, in supplying information requested, and shall provide any assistance practicable.

12.12 The procedures set out above are not intended to prevent the authorities of a Member from proceeding expeditiously with regard to initiating an investigation, reaching preliminary or final determinations, whether affirmative or negative, or from applying provisional or final measures, in accordance with relevant provisions of this Agreement.

#### Article 13

##### Consultations

13.1 As soon as possible after an application under Article 11 is accepted, and in any event before the initiation of any investigation, Members the products of which may be subject to such investigation shall be invited for consultations with the aim of clarifying the situation as to the matters referred to in paragraph 2 of Article 11 and arriving at a mutually agreed solution.

13.2 Furthermore, throughout the period of investigation, Members the products of which are the subject of the investigation shall be afforded a reasonable opportunity to continue consultations, with a view to clarifying the factual situation and to arriving at a mutually agreed solution.<sup>44</sup>

13.3 Without prejudice to the obligation to afford reasonable opportunity for consultation, these provisions regarding consultations are not intended to prevent the authorities of a Member from proceeding expeditiously with regard to initiating the investigation, reaching preliminary or final determinations, whether affirmative or negative, or from applying provisional or final measures, in accordance with the provisions of this Agreement.

13.4 The Member which intends to initiate any investigation or is conducting such an investigation shall permit, upon request, the Member or Members the products of which are subject to such

<sup>44</sup>It is particularly important, in accordance with the provisions of this paragraph, that no affirmative determination whether preliminary or final be made without reasonable opportunity for consultations having been given. Such consultations may establish the basis for proceeding under the provisions of Part II, III or X.

investigation access to non-confidential evidence, including the non-confidential summary of confidential data being used for initiating or conducting the investigation.

#### Article 14

##### Calculation of the Amount of a Subsidy in Terms of the Benefit to the Recipient

For the purpose of Part V, any method used by the investigating authority to calculate the benefit to the recipient conferred pursuant to paragraph 1 of Article 1 shall be provided for in the national legislation or implementing regulations of the Member concerned and its application to each particular case shall be transparent and adequately explained. Furthermore, any such method shall be consistent with the following guidelines:

- (a) government provision of equity capital shall not be considered as conferring a benefit, unless the investment decision can be regarded as inconsistent with the usual investment practice (including for the provision of risk capital) of private investors in the territory of that Member;
- (b) a loan by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the loan pays on the government loan and the amount the firm would pay on a comparable commercial loan which the firm could actually obtain on the market. In this case the benefit shall be the difference between these two amounts;
- (c) a loan guaranteed by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee. In this case the benefit shall be the difference between these two amounts adjusted for any differences in fees;
- (d) the provision of goods or services or purchase of goods by a government shall not be considered as conferring a benefit unless the provision is made for less than adequate remuneration, or the purchase is made for more than adequate remuneration. The adequacy of remuneration shall be determined in relation to prevailing market conditions for the good or service in question in the country of provision or purchase (including price, quality, availability, marketability, transportation and other conditions of purchase or sale).

#### Article 15

##### Determination of Injury<sup>45</sup>

15.1 A determination of injury for purposes of Article VI of GATT 1994 shall be based on positive evidence and involve an objective examination of both (a) the volume of the subsidized imports and

<sup>45</sup>Under this Agreement the term "injury" shall, unless otherwise specified, be taken to mean material injury to a domestic industry, threat of material injury to a domestic industry or material retardation of the establishment of such an industry and shall be interpreted in accordance with the provisions of this Article.

the effect of the subsidized imports on prices in the domestic market for like products<sup>46</sup> and (b) the consequent impact of these imports on the domestic producers of such products.

15.2 With regard to the volume of the subsidized imports, the investigating authorities shall consider whether there has been a significant increase in subsidized imports, either in absolute terms or relative to production or consumption in the importing Member. With regard to the effect of the subsidized imports on prices, the investigating authorities shall consider whether there has been a significant price undercutting by the subsidized imports as compared with the price of a like product of the importing Member, or whether the effect of such imports is otherwise to depress prices to a significant degree or to prevent price increases, which otherwise would have occurred, to a significant degree. No one or several of these factors can necessarily give decisive guidance.

15.3 Where imports of a product from more than one country are simultaneously subject to countervailing duty investigations, the investigating authorities may cumulatively assess the effects of such imports only if they determine that (a) the amount of subsidization established in relation to the imports from each country is more than *de minimis* as defined in paragraph 9 of Article 11 and the volume of imports from each country is not negligible and (b) a cumulative assessment of the effects of the imports is appropriate in light of the conditions of competition between the imported products and the conditions of competition between the imported products and the like domestic product.

15.4 The examination of the impact of the subsidized imports on the domestic industry shall include an evaluation of all relevant economic factors and indices having a bearing on the state of the industry, including actual and potential decline in output, sales, market share, profits, productivity, return on investments, or utilization of capacity; factors affecting domestic prices; actual and potential negative effects on cash flow, inventories, employment, wages, growth, ability to raise capital or investments and, in the case of agriculture, whether there has been an increased burden on government support programmes. This list is not exhaustive, nor can one or several of these factors necessarily give decisive guidance.

15.5 It must be demonstrated that the subsidized imports are, through the effects<sup>47</sup> of subsidies, causing injury within the meaning of this Agreement. The demonstration of a causal relationship between the subsidized imports and the injury to the domestic industry shall be based on an examination of all relevant evidence before the authorities. The authorities shall also examine any known factors other than the subsidized imports which at the same time are injuring the domestic industry, and the injuries caused by these other factors must not be attributed to the subsidized imports. Factors which may be relevant in this respect include, *inter alia*, the volumes and prices of non-subsidized imports of the product in question, contraction in demand or changes in the patterns of consumption, trade restrictive practices of and competition between the foreign and domestic producers, developments in technology and the export performance and productivity of the domestic industry.

15.6 The effect of the subsidized imports shall be assessed in relation to the domestic production of the like product when available data permit the separate identification of that production on the basis of such criteria as the production process, producers' sales and profits. If such separate identification of that production is not possible, the effects of the subsidized imports shall be assessed by the examination of the production of the narrowest group or range of products, which includes the like product, for which the necessary information can be provided.

<sup>46</sup>Throughout this Agreement the term "like product" ("produit similaire") shall be interpreted to mean a product which is identical, i.e. alike in all respects to the product under consideration, or in the absence of such a product, another product which, although not alike in all respects, has characteristics closely resembling those of the product under consideration.

<sup>47</sup>As set forth in paragraphs 2 and 4.

15.7 A determination of a threat of material injury shall be based on facts and not merely on a allegation, conjecture or remote possibility. The change in circumstances which would create a situation in which the subsidy would cause injury must be clearly foreseen and imminent. In making a determination regarding the existence of a threat of material injury, the investigating authorities should consider, *inter alia*, such factors as:

- (i) nature of the subsidy or subsidies in question and the trade effects likely to arise therefrom;
- (ii) a significant rate of increase of subsidized imports into the domestic market indicating the likelihood of substantially increased importation;
- (iii) sufficient freely disposable, or an imminent, substantial increase in, capacity of the exporter indicating the likelihood of substantially increased subsidized exports to the importing Member's market, taking into account the availability of other export markets to absorb any additional exports;
- (iv) whether imports are entering at prices that will have a significant depressing or suppressing effect on domestic prices, and would likely increase demand for further imports; and
- (v) inventories of the product being investigated.

No one of these factors by itself can necessarily give decisive guidance but the totality of the factors considered must lead to the conclusion that further subsidized exports are imminent and that, unless protective action is taken, material injury would occur.

15.8 With respect to cases where injury is threatened by subsidized imports, the application of countervailing measures shall be considered and decided with special care.

## Article 16

### Definition of Domestic Industry

16.1 For the purposes of this Agreement, the term "domestic industry" shall, except as provided in paragraph 2, be interpreted as referring to the domestic producers as a whole of the like products or to those of them whose collective output of the products constitutes a major proportion of the total domestic production of those products, except that when producers are related<sup>48</sup> to the exporters or importers or are themselves importers of the allegedly subsidized product or a like product from other countries, the term "domestic industry" may be interpreted as referring to the rest of the producers.

16.2 In exceptional circumstances, the territory of a Member may, for the production in question, be divided into two or more competitive markets and the producers within each market may be regarded as a separate industry if (a) the producers within such market sell all or almost all of their production of the product in question in that market, and (b) the demand in that market is not to any substantial

<sup>48</sup>For the purpose of this paragraph, producers shall be deemed to be related to exporters or importers only if (a) one of them directly or indirectly controls the other; or (b) both of them are directly or indirectly controlled by a third person; or (c) together they directly or indirectly control a third person, provided that there are grounds for believing or suspecting that the effect of the relationship is such as to cause the producer concerned to behave differently from non-related producers. For the purpose of this paragraph, one shall be deemed to control another when the former is legally or operationally in a position to exercise restraint or direction over the latter.

degree supplied by producers of the product in question located elsewhere in the territory. In such circumstances, injury may be found to exist even where a major portion of the total domestic industry is not injured, provided there is a concentration of subsidized imports into such an isolated market and provided further that the subsidized imports are causing injury to the producers of all or almost all of the production within such market.

16.3 When the domestic industry has been interpreted as referring to the producers in a certain area, i.e. a market as defined in paragraph 2, countervailing duties shall be levied only on the products in question consigned for final consumption to that area. When the constitutional law of the importing Member does not permit the levying of countervailing duties on such a basis, the importing Member may levy the countervailing duties without limitation only if (a) the exporters shall have been given an opportunity to cease exporting at subsidized prices to the area concerned or otherwise give assurances pursuant to Article 18, and adequate assurances in this regard have not been promptly given, and (b) such duties cannot be levied only on products of specific producers which supply the area in question.

16.4 Where two or more countries have reached under the provisions of paragraph 8(a) of Article XXIV of GATT 1994 such a level of integration that they have the characteristics of a single, unified market, the industry in the entire area of integration shall be taken to be the domestic industry referred to in paragraphs 1 and 2.

16.5 The provisions of paragraph 6 of Article 15 shall be applicable to this Article.

#### Article 17

##### Provisional Measures

17.1 Provisional measures may be applied only if:

- (a) an investigation has been initiated in accordance with the provisions of Article 11, a public notice has been given to that effect and interested Members and interested parties have been given adequate opportunities to submit information and make comments;
- (b) a preliminary affirmative determination has been made that a subsidy exists and that there is injury to a domestic industry caused by subsidized imports; and
- (c) the authorities concerned judge such measures necessary to prevent injury being caused during the investigation.

17.2 Provisional measures may take the form of provisional countervailing duties guaranteed by cash deposits or bonds equal to the amount of the provisionally calculated amount of subsidization.

17.3 Provisional measures shall not be applied sooner than 60 days from the date of initiation of the investigation.

17.4 The application of provisional measures shall be limited to as short a period as possible, not exceeding four months.

17.5 The relevant provisions of Article 19 shall be followed in the application of provisional measures.

#### Article 18

##### Undertakings

18.1 Proceedings may<sup>49</sup> be suspended or terminated without the imposition of provisional measures or countervailing duties upon receipt of satisfactory voluntary undertakings under which:

- (a) the government of the exporting Member agrees to eliminate or limit the subsidy or take other measures concerning its effects; or
- (b) the exporter agrees to revise its prices so that the investigating authorities are satisfied that the injurious effect of the subsidy is eliminated. Price increases under such undertakings shall not be higher than necessary to eliminate the amount of the subsidy. It is desirable that the price increases be less than the amount of the subsidy if such increases would be adequate to remove the injury to the domestic industry.

18.2 Undertakings shall not be sought or accepted unless the authorities of the importing Member have made a preliminary affirmative determination of subsidization and injury caused by such subsidization and, in case of undertakings from exporters, have obtained the consent of the exporting Member.

18.3 Undertakings offered need not be accepted if the authorities of the importing Member consider their acceptance impractical, for example if the number of actual or potential exporters is too great, or for other reasons, including reasons of general policy. Should the case arise and where practicable, the authorities shall provide to the exporter the reasons which have led them to consider acceptance of an undertaking as inappropriate, and shall, to the extent possible, give the exporter an opportunity to make comments thereon.

18.4 If an undertaking is accepted, the investigation of subsidization and injury shall nevertheless be completed if the exporting Member so desires or the importing Member so decides. In such a case, if a negative determination of subsidization or injury is made, the undertaking shall automatically lapse, except in cases where such a determination is due in large part to the existence of an undertaking. In such cases, the authorities concerned may require that an undertaking be maintained for a reasonable period consistent with the provisions of this Agreement. In the event that an affirmative determination of subsidization and injury is made, the undertaking shall continue consistent with its terms and the provisions of this Agreement.

18.5 Price undertakings may be suggested by the authorities of the importing Member, but no exporter shall be forced to enter into such undertakings. The fact that governments or exporters do not offer such undertakings, or do not accept an invitation to do so, shall in no way prejudice the consideration of the case. However, the authorities are free to determine that a threat of injury is more likely to be realized if the subsidized imports continue.

18.6 Authorities of an importing Member may require any government or exporter from whom an undertaking has been accepted to provide periodically information relevant to the fulfillment of such an undertaking, and to permit verification of pertinent data. In case of violation of an undertaking, the authorities of the importing Member may take, under this Agreement in conformity with its provisions, expeditious actions which may constitute immediate application of provisional measures using the best information available. In such cases, definitive duties may be levied in accordance with

<sup>49</sup>The word "may" shall not be interpreted to allow the simultaneous continuation of proceedings with the implementation of undertakings, except as provided in paragraph 4.

this Agreement on products entered for consumption not more than 90 days before the application of such provisional measures, except that any such retroactive assessment shall not apply to imports entered before the violation of the undertaking.

#### Article 19

##### *Imposition and Collection of Countervailing Duties*

19.1 If, after reasonable efforts have been made to complete consultations, a Member makes a final determination of the existence and amount of the subsidy and that, through the effects of the subsidy, the subsidized imports are causing injury, it may impose a countervailing duty in accordance with the provisions of this Article unless the subsidy or subsidies are withdrawn.

19.2 The decision whether or not to impose a countervailing duty in cases where all requirements for the imposition have been fulfilled, and the decision whether the amount of the countervailing duty to be imposed shall be the full amount of the subsidy or less, are decisions to be made by the authorities of the importing Member. It is desirable that the imposition should be permissive in the territory of all Members, that the duty should be less than the total amount of the subsidy if such lesser duty would be adequate to remove the injury to the domestic industry, and that procedures should be established which would allow the authorities concerned to take due account of representations made by domestic interested parties<sup>50</sup> whose interests might be adversely affected by the imposition of a countervailing duty.

19.3 When a countervailing duty is imposed in respect of any product, such countervailing duty shall be levied, in the appropriate amounts in each case, on a non-discriminatory basis on imports of such product from all sources found to be subsidized and causing injury, except as to imports from those sources which have renounced any subsidies in question or from which undertakings under the terms of this Agreement have been accepted. Any exporter whose exports are subject to a definitive countervailing duty but who was not actually investigated for reasons other than a refusal to cooperate, shall be entitled to an expedited review in order that the investigating authorities promptly establish an individual countervailing duty rate for that exporter.

19.4 No countervailing duty shall be levied<sup>51</sup> on any imported product in excess of the amount of the subsidy found to exist, calculated in terms of subsidization per unit of the subsidized and exported product.

#### Article 20

##### *Retroactivity*

20.1 Provisional measures and countervailing duties shall only be applied to products which enter for consumption after the time when the decision under paragraph 1 of Article 17 and paragraph 1 of Article 19, respectively, enters into force, subject to the exceptions set out in this Article.

20.2 Where a final determination of injury (but not of a threat thereof or of a material retardation of the establishment of an industry) is made or, in the case of a final determination of a threat of injury,

<sup>50</sup>For the purpose of this paragraph, the term "domestic interested parties" shall include consumers and industrial users of the imported product subject to investigation.

<sup>51</sup>As used in this Agreement "levy" shall mean the definitive or final legal assessment or collection of a duty or tax.

where the effect of the subsidized imports would, in the absence of the provisional measures, have led to a determination of injury, countervailing duties may be levied retroactively for the period for which provisional measures, if any, have been applied.

20.3 If the definitive countervailing duty is higher than the amount guaranteed by the cash deposit or bond, the difference shall not be collected. If the definitive duty is less than the amount guaranteed by the cash deposit or bond, the excess amount shall be reimbursed or the bond released in an expeditious manner.

20.4 Except as provided in paragraph 2, where a determination of threat of injury or material retardation is made (but no injury has yet occurred) a definitive countervailing duty may be imposed only from the date of the determination of threat of injury or material retardation, and any cash deposit made during the period of the application of provisional measures shall be refunded and any bonds released in an expeditious manner.

20.5 Where a final determination is negative, any cash deposit made during the period of the application of provisional measures shall be refunded and any bonds released in an expeditious manner.

20.6 In critical circumstances where for the subsidized product in question the authorities find that injury which is difficult to repair is caused by massive imports in a relatively short period of a product benefiting from subsidies paid or bestowed inconsistently with the provisions of GATT 1994 and of this Agreement and where it is deemed necessary, in order to preclude the recurrence of such injury, to assess countervailing duties retroactively on those imports, the definitive countervailing duties may be assessed on imports which were entered for consumption not more than 90 days prior to the date of application of provisional measures.

#### Article 21

##### *Duration and Review of Countervailing Duties and Undertakings*

21.1 A countervailing duty shall remain in force only as long as and to the extent necessary to counteract subsidization which is causing injury.

21.2 The authorities shall review the need for the continued imposition of the duty, where warranted, on their own initiative or, provided that a reasonable period of time has elapsed since the imposition of the definitive countervailing duty, upon request by any interested party which submits positive information substantiating the need for a review. Interested parties shall have the right to request the authorities to examine whether the continued imposition of the duty is necessary to offset subsidization, whether the injury would be likely to continue or recur if the duty were removed or varied, or both. If, as a result of the review under this paragraph, the authorities determine that the countervailing duty is no longer warranted, it shall be terminated immediately.

21.3 Notwithstanding the provisions of paragraphs 1 and 2, any definitive countervailing duty shall be terminated on a date not later than five years from its imposition (or from the date of the most recent review under paragraph 2 if that review has covered both subsidization and injury, or under this paragraph), unless the authorities determine, in a review initiated before that date on their own initiative or upon a duly substantiated request made by or on behalf of the domestic industry within a reasonable period of time prior to that date, that the expiry of the duty would be likely to lead to continuation

22.4 A public notice of the imposition of provisional measures shall set forth, or otherwise make available through a separate report, sufficiently detailed explanations for the preliminary determinations on the existence of a subsidy and injury and shall refer to the matters of fact and law which have led to arguments being accepted or rejected. Such a notice or report shall, due regard being paid to the requirement for the protection of confidential information, contain in particular:

- (i) the names of the suppliers or, when this is impracticable, the supplying countries involved;
- (ii) a description of the product which is sufficient for customs purposes;
- (iii) the amount of subsidy established and the basis on which the existence of a subsidy has been determined;
- (iv) considerations relevant to the injury determination as set out in Article 15;
- (v) the main reasons leading to the determination.

22.5 A public notice of conclusion or suspension of an investigation in the case of an affirmative determination providing for the imposition of a definitive duty or the acceptance of an undertaking shall contain, or otherwise make available through a separate report, all relevant information on the matters of fact and law and reasons which have led to the imposition of final measures or the acceptance of an undertaking, due regard being paid to the requirement for the protection of confidential information. In particular, the notice or report shall contain the information described in paragraph 4, as well as the reasons for the acceptance or rejection of relevant arguments or claims made by interested Members and by the exporters and importers.

22.6 A public notice of the termination or suspension of an investigation following the acceptance of an undertaking pursuant to Article 18 shall include, or otherwise make available through a separate report, the non-confidential part of this undertaking.

22.7 The provisions of this Article shall apply *mutatis mutandis* to the initiation and completion of reviews pursuant to Article 21 and to decisions under Article 20 to apply duties retroactively.

#### Article 23

##### Judicial Review

Each Member whose national legislation contains provisions on countervailing duty measures shall maintain judicial, arbitral or administrative tribunals or procedures for the purpose, *inter alia*, of the prompt review of administrative actions relating to final determinations and reviews of determinations within the meaning of Article 21. Such tribunals or procedures shall be independent of the authorities responsible for the determination or review in question, and shall provide all interested parties who participated in the administrative proceeding and are directly and individually affected by the administrative actions with access to review.

or recurrence of subsidization and injury.<sup>52</sup> The duty may remain in force pending the outcome of such a review.

21.4 The provisions of Article 12 regarding evidence and procedure shall apply to any review carried out under this Article. Any such review shall be carried out expeditiously and shall normally be concluded within 12 months of the date of initiation of the review.

21.5 The provisions of this Article shall apply *mutatis mutandis* to undertakings accepted under Article 18.

#### Article 22

##### Public Notice and Explanation of Determinations

22.1 When the authorities are satisfied that there is sufficient evidence to justify the initiation of an investigation pursuant to Article 11, the Member or Members the products of which are subject to such investigation and other interested parties known to the investigating authorities to have an interest therein shall be notified and a public notice shall be given.

22.2 A public notice of the initiation of an investigation shall contain, or otherwise make available through a separate report<sup>53</sup>, adequate information on the following:

- (i) the name of the exporting country or countries and the product involved;
- (ii) the date of initiation of the investigation;
- (iii) a description of the subsidy practice or practices to be investigated;
- (iv) a summary of the factors on which the allegation of injury is based;
- (v) the address to which representations by interested Members and interested parties should be directed; and
- (vi) the time-limits allowed to interested Members and interested parties for making their views known.

22.3 Public notice shall be given of any preliminary or final determination, whether affirmative or negative, of any decision to accept an undertaking pursuant to Article 18, of the termination of such an undertaking, and of the termination of a definitive countervailing duty. Each such notice shall set forth, or otherwise make available through a separate report, in sufficient detail the findings and conclusions reached on all issues of fact and law considered material by the investigating authorities. All such notices and reports shall be forwarded to the Member or Members the products of which are subject to such determination or undertaking and to other interested parties known to have an interest therein.

<sup>52</sup>When the amount of the countervailing duty is assessed on a retrospective basis, a finding in the most recent assessment proceeding that no duty is to be levied shall not by itself require the authorities to terminate the definitive duty.

<sup>53</sup>Where authorities provide information and explanations under the provisions of this Article in a separate report, they shall ensure that such report is readily available to the public.

## PART VI: INSTITUTIONS

*Article 24**Committee on Subsidies and Countervailing Measures and Subsidiary Bodies*

24.1 There is hereby established a Committee on Subsidies and Countervailing Measures composed of representatives from each of the Members. The Committee shall elect its own Chairman and shall meet not less than twice a year and otherwise as envisaged by relevant provisions of this Agreement at the request of any Member. The Committee shall carry out responsibilities as assigned to it under this Agreement or by the Members and it shall afford Members the opportunity of consulting on any matter relating to the operation of the Agreement or the furtherance of its objectives. The WTO Secretariat shall act as the secretariat to the Committee.

24.2 The Committee may set up subsidiary bodies as appropriate.

24.3 The Committee shall establish a Permanent Group of Experts composed of five independent persons, highly qualified in the fields of subsidies and trade relations. The experts will be elected by the Committee and one of them will be replaced every year. The PGE may be requested to assist a panel, as provided for in paragraph 5 of Article 4. The Committee may also seek an advisory opinion on the existence and nature of any subsidy.

24.4 The PGE may be consulted by any Member and may give advisory opinions on the nature of any subsidy proposed to be introduced or currently maintained by that Member. Such advisory opinions will be confidential and may not be invoked in proceedings under Article 7.

24.5 In carrying out their functions, the Committee and any subsidiary bodies may consult with and seek information from any source they deem appropriate. However, before the Committee or a subsidiary body seeks such information from a source within the jurisdiction of a Member, it shall inform the Member involved.

## PART VII: NOTIFICATION AND SURVEILLANCE

*Article 25**Notifications*

25.1 Members agree that, without prejudice to the provisions of paragraph 1 of Article XVI of GATT 1994, their notifications of subsidies shall be submitted not later than 30 June of each year and shall conform to the provisions of paragraphs 2 through 6.

25.2 Members shall notify any subsidy as defined in paragraph 1 of Article 1, which is specific within the meaning of Article 2, granted or maintained within their territories.

25.3 The content of notifications should be sufficiently specific to enable other Members to evaluate the trade effects and to understand the operation of notified subsidy programmes. In this connection,

and without prejudice to the contents and form of the questionnaire on subsidies<sup>54</sup>, Members shall ensure that their notifications contain the following information:

- (i) form of a subsidy (i.e. grant, loan, tax concession, etc.);
- (ii) subsidy per unit or, in cases where this is not possible, the total amount or the annual amount budgeted for that subsidy (indicating, if possible, the average subsidy per unit in the previous year);
- (iii) policy objective and/or purpose of a subsidy;
- (iv) duration of a subsidy and/or any other time-limits attached to it;
- (v) statistical data permitting an assessment of the trade effects of a subsidy.

25.4 Where specific points in paragraph 3 have not been addressed in a notification, an explanation shall be provided in the notification itself.

25.5 If subsidies are granted to specific products or sectors, the notifications should be organized by product or sector.

25.6 Members which consider that there are no measures in their territories requiring notification under paragraph 1 of Article XVI of GATT 1994 and this Agreement shall so inform the Secretariat in writing.

25.7 Members recognize that notification of a measure does not prejudice either its legal status under GATT 1994 and this Agreement, the effects under this Agreement, or the nature of the measure itself.

25.8 Any Member may, at any time, make a written request for information on the nature and extent of any subsidy granted or maintained by another Member (including any subsidy referred to in Part IV), or for an explanation of the reasons for which a specific measure has been considered as not subject to the requirement of notification.

25.9 Members so requested shall provide such information as quickly as possible and in a comprehensive manner, and shall be ready, upon request, to provide additional information to the requesting Member. In particular, they shall provide sufficient details to enable the other Member to assess their compliance with the terms of this Agreement. Any Member which considers that such information has not been provided may bring the matter to the attention of the Committee.

25.10 Any Member which considers that any measure of another Member having the effects of a subsidy has not been notified in accordance with the provisions of paragraph 1 of Article XVI of GATT 1994 and this Article may bring the matter to the attention of such other Member. If the alleged subsidy is not thereafter notified promptly, such Member may itself bring the alleged subsidy in question to the notice of the Committee.

25.11 Members shall report without delay to the Committee all preliminary or final actions taken with respect to countervailing duties. Such reports shall be available in the Secretariat for inspection by other Members. Members shall also submit, on a semi-annual basis, reports on any countervailing duty actions taken within the preceding six months. The semi-annual reports shall be submitted on an agreed standard form.

<sup>54</sup>The Committee shall establish a Working Party to review the contents and form of the questionnaire as contained in BISD 9S/193-194.

25.12 Each Member shall notify the Committee (a) which of its authorities are competent to initiate and conduct investigations referred to in Article 11 and (b) its domestic procedures governing the initiation and conduct of such investigations.

#### Article 26

##### *Surveillance*

26.1 The Committee shall examine new and full notifications submitted under paragraph 1 of Article XVI of GATT 1994 and paragraph 1 of Article 25 of this Agreement at special sessions held every third year. Notifications submitted in the intervening years (updating notifications) shall be examined at each regular meeting of the Committee.

26.2 The Committee shall examine reports submitted under paragraph 11 of Article 25 at each regular meeting of the Committee.

### PART VIII: DEVELOPING COUNTRY MEMBERS

#### Article 27

##### *Special and Differential Treatment of Developing Country Members*

27.1 Members recognize that subsidies may play an important role in economic development programmes of developing country Members.

27.2 The prohibition of paragraph 1(a) of Article 3 shall not apply to:

- (a) developing country Members referred to in Annex VII.
- (b) other developing country Members for a period of eight years from the date of entry into force of the WTO Agreement, subject to compliance with the provisions in paragraph 4.

27.3 The prohibition of paragraph 1(b) of Article 3 shall not apply to developing country Members for a period of five years, and shall not apply to least developed country Members for a period of eight years, from the date of entry into force of the WTO Agreement.

27.4 Any developing country Member referred to in paragraph 2(b) shall phase out its export subsidies within the eight-year period, preferably in a progressive manner. However, a developing country Member shall not increase the level of its export subsidies<sup>55</sup>, and shall eliminate them within a period shorter than that provided for in this paragraph when the use of such export subsidies is inconsistent with its development needs. If a developing country Member deems it necessary to apply such subsidies beyond the 8-year period, it shall not later than one year before the expiry of this period enter into consultation with the Committee, which will determine whether an extension of this period is justified, after examining all the relevant economic, financial and development needs of the developing country Member in question. If the Committee determines that the extension is justified, the developing country Member concerned shall hold annual consultations with the Committee to determine the necessity of

<sup>55</sup>For a developing country Member not granting export subsidies as of the date of entry into force of the WTO Agreement, this paragraph shall apply on the basis of the level of export subsidies granted in 1986.

maintaining the subsidies. If no such determination is made by the Committee, the developing country Member shall phase out the remaining export subsidies within two years from the end of the last authorized period.

27.5 A developing country Member which has reached export competitiveness in any given product shall phase out its export subsidies for such product(s) over a period of two years. However, for a developing country Member which is referred to in Annex VII and which has reached export competitiveness in one or more products, export subsidies on such products shall be gradually phased out over a period of eight years.

27.6 Export competitiveness in a product exists if a developing country Member's exports of that product have reached a share of at least 3.25 per cent in world trade of that product for two consecutive calendar years. Export competitiveness shall exist either (a) on the basis of notification by the developing country Member having reached export competitiveness, or (b) on the basis of a computation undertaken by the Secretariat at the request of any Member. For the purpose of this paragraph, a product is defined as a section heading of the Harmonized System Nomenclature. The Committee shall review the operation of this provision five years from the date of the entry into force of the WTO Agreement.

27.7 The provisions of Article 4 shall not apply to a developing country Member in the case of export subsidies which are in conformity with the provisions of paragraphs 2 through 5. The relevant provisions in such a case shall be those of Article 7.

27.8 There shall be no presumption in terms of paragraph 1 of Article 6 that a subsidy granted by a developing country Member results in serious prejudice, as defined in this Agreement. Such serious prejudice, where applicable under the terms of paragraph 9, shall be demonstrated by positive evidence, in accordance with the provisions of paragraphs 3 through 8 of Article 6.

27.9 Regarding actionable subsidies granted or maintained by a developing country Member other than those referred to in paragraph 1 of Article 6, action may not be authorized or taken under Article 7 unless nullification or impairment of tariff concessions or other obligations under GATT 1994 is found to exist as a result of such a subsidy, in such a way as to displace or impede imports of a like product of another Member into the market of the subsidizing developing country Member or unless injury to a domestic industry in the market of an importing Member occurs.

27.10 Any countervailing duty investigation of a product originating in a developing country Member shall be terminated as soon as the authorities concerned determine that:

- (a) the overall level of subsidies granted upon the product in question does not exceed 2 per cent of its value calculated on a per unit basis; or
- (b) the volume of the subsidized imports represents less than 4 per cent of the total imports of the like product in the importing Member, unless imports from developing country Members whose individual shares of total imports represent less than 4 per cent collectively account for more than 9 per cent of the total imports of the like product in the importing Member.

27.11 For those developing country Members within the scope of paragraph 2(b) which have eliminated export subsidies prior to the expiry of the period of eight years from the date of entry into force of the WTO Agreement, and for those developing country Members referred to in Annex VII, the number in paragraph 10(a) shall be 3 per cent rather than 2 per cent. This provision shall apply from the date that the elimination of export subsidies is notified to the Committee, and for so long as export subsidies are not granted by the notifying developing country Member. This provision shall expire eight years from the date of entry into force of the WTO Agreement.

27.12 The provisions of paragraphs 10 and 11 shall govern any determination of *de minimis* under paragraph 3 of Article 15.

27.13 The provisions of Part III shall not apply to direct forgiveness of debts, subsidies to cover social costs, in whatever form, including relinquishment of government revenue and other transfer of liabilities when such subsidies are granted within and directly linked to a privatization programme of a developing country Member, provided that both such programme and the subsidies involved are granted for a limited period and notified to the Committee and that the programme results in eventual privatization of the enterprise concerned.

27.14 The Committee shall, upon request by an interested Member, undertake a review of a specific export subsidy practice of a developing country Member to examine whether the practice is in conformity with its development needs.

27.15 The Committee shall, upon request by an interested developing country Member, undertake a review of a specific countervailing measure to examine whether it is consistent with the provisions of paragraphs 10 and 11 as applicable to the developing country Member in question.

#### PART IX: TRANSITIONAL ARRANGEMENTS

##### *Article 28*

###### *Existing Programmes*

28.1 Subsidy programmes which have been established within the territory of any Member before the date on which such a Member signed the WTO Agreement and which are inconsistent with the provisions of this Agreement shall be:

- (a) notified to the Committee not later than 90 days after the date of entry into force of the WTO Agreement for such Member; and
- (b) brought into conformity with the provisions of this Agreement within three years of the date of entry into force of the WTO Agreement for such Member and until then shall not be subject to Part II.

28.2 No Member shall extend the scope of any such programme, nor shall such a programme be renewed upon its expiry.

##### *Article 29*

###### *Transformation into a Market Economy*

29.1 Members in the process of transformation from a centrally-planned into a market, free-enterprise economy may apply programmes and measures necessary for such a transformation.

29.2 For such Members, subsidy programmes falling within the scope of Article 3, and notified according to paragraph 3, shall be phased out or brought into conformity with Article 3 within a period of seven years from the date of entry into force of the WTO Agreement. In such a case, Article 4 shall not apply. In addition during the same period:

(a) Subsidy programmes falling within the scope of paragraph 1(d) of Article 6 shall not be actionable under Article 7;

(b) With respect to other actionable subsidies, the provisions of paragraph 9 of Article 27 shall apply.

29.3 Subsidy programmes falling within the scope of Article 3 shall be notified to the Committee by the earliest practicable date after the date of entry into force of the WTO Agreement. Further notifications of such subsidies may be made up to two years after the date of entry into force of the WTO Agreement.

29.4 In exceptional circumstances Members referred to in paragraph 1 may be given departures from their notified programmes and measures and their time-frame by the Committee if such departures are deemed necessary for the process of transformation.

#### PART X: DISPUTE SETTLEMENT

##### *Article 30*

The provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding shall apply to consultations and the settlement of disputes under this Agreement, except as otherwise specifically provided herein.

#### PART XI: FINAL PROVISIONS

##### *Article 31*

###### *Provisional Application*

The provisions of paragraph 1 of Article 6 and the provisions of Article 8 and Article 9 shall apply for a period of five years, beginning with the date of entry into force of the WTO Agreement. Not later than 180 days before the end of this period, the Committee shall review the operation of those provisions, with a view to determining whether to extend their application, either as presently drafted or in a modified form, for a further period.

##### *Article 32*

###### *Other Final Provisions*

32.1 No specific action against a subsidy of another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement.<sup>66</sup>

32.2 Reservations may not be entered in respect of any of the provisions of this Agreement without the consent of the other Members.

<sup>66</sup>This paragraph is not intended to preclude action under other relevant provisions of GATT 1994, where appropriate.

32.3 Subject to paragraph 4, the provisions of this Agreement shall apply to investigations, and reviews of existing measures, initiated pursuant to applications which have been made on or after the date of entry into force for a Member of the WTO Agreement.

32.4 For the purposes of paragraph 3 of Article 21, existing countervailing measures shall be deemed to be imposed on a date not later than the date of entry into force for a Member of the WTO Agreement, except in cases in which the domestic legislation of a Member in force at that date already included a clause of the type provided for in that paragraph.

32.5 Each Member shall take all necessary steps, of a general or particular character, to ensure, not later than the date of entry into force of the WTO Agreement for it, the conformity of its laws, regulations and administrative procedures with the provisions of this Agreement as they may apply to the Member in question.

32.6 Each Member shall inform the Committee of any changes in its laws and regulations relevant to this Agreement and in the administration of such laws and regulations.

32.7 The Committee shall review annually the implementation and operation of this Agreement, taking into account the objectives thereof. The Committee shall inform annually the Council for Trade in Goods of developments during the period covered by such reviews.

32.8 The Annexes to this Agreement constitute an integral part thereof.

## ANNEX I

## ILLUSTRATIVE LIST OF EXPORT SUBSIDIES

- (a) The provision by governments of direct subsidies to a firm or an industry contingent upon export performance.
- (b) Currency retention schemes or any similar practices which involve a bonus on exports.
- (c) Internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favourable than for domestic shipments.
- (d) The provision by governments or their agencies either directly or indirectly through government-mandated schemes, of imported or domestic products or services for use in the production of exported goods, on terms or conditions more favourable than for provision of like or directly competitive products or services for use in the production of goods for domestic consumption, if (in the case of products) such terms or conditions are more favourable than those commercially available<sup>57</sup> on world markets to their exporters.
- (e) The full or partial exemption remission, or deferral specifically related to exports, of direct taxes<sup>58</sup> or social welfare charges paid or payable by industrial or commercial enterprises.<sup>59</sup>
- (f) The allowance of special deductions directly related to exports or export performance, over and above those granted in respect to production for domestic consumption, in the calculation of the base on which direct taxes are charged.

<sup>57</sup>The term "commercially available" means that the choice between domestic and imported products is unrestricted and depends only on commercial considerations.

<sup>58</sup>For the purpose of this Agreement:

The term "direct taxes" shall mean taxes on wages, profits, interests, rents, royalties, and all other forms of income, and taxes on the ownership of real property;

The term "import charges" shall mean tariffs, duties, and other fiscal charges not elsewhere enumerated in this note that are levied on imports;

The term "indirect taxes" shall mean sales, excise, turnover, value added, franchise, stamp, transfer, inventory and equipment taxes, border taxes and all taxes other than direct taxes and import charges;

"Prior-stage" indirect taxes are those levied on goods or services used directly or indirectly in making the product;

"Cumulative" indirect taxes are multi-staged taxes levied where there is no mechanism for subsequent crediting of the tax if the goods or services subject to tax at one stage of production are used in a succeeding stage of production;

"Remission" of taxes includes the refund or rebate of taxes;

"Remission or drawback" includes the full or partial exemption or deferral of import charges.

<sup>59</sup>The Members recognize that deferral need not amount to an export subsidy where, for example, appropriate interest charges are collected. The Members reaffirm the principle that prices for goods in transactions between exporting enterprises and foreign buyers under their or under the same control should for tax purposes be the prices which would be charged between independent enterprises acting at arm's length. Any Member may draw the attention of another Member to administrative or other practices which may contravene this principle and which result in a significant saving of direct taxes in export transactions. In such circumstances the Members shall normally attempt to resolve their differences using the facilities of existing bilateral tax treaties or other specific international mechanisms, without prejudice to the rights and obligations of Members under GATT 1994, including the right of consultation created in the preceding sentence.

Paragraph (e) is not intended to limit a Member from taking measures to avoid the double taxation of foreign-source income earned by its enterprises or the enterprises of another Member.

- (g) The exemption or remission, in respect of the production and distribution of exported products, of indirect taxes<sup>58</sup> in excess of those levied in respect of the production and distribution of like products when sold for domestic consumption.
- (h) The exemption, remission or deferral of prior-stage cumulative indirect taxes<sup>58</sup> on goods or services used in the production of exported products in excess of the exemption, remission or deferral of like prior-stage cumulative indirect taxes on goods or services used in the production of like products when sold for domestic consumption; provided, however, that prior-stage cumulative indirect taxes may be exempted, remitted or deferred on exported products even when not exempted, remitted or deferred on like products when sold for domestic consumption, if the prior-stage cumulative indirect taxes are levied on inputs that are consumed in the production of the exported product (making normal allowance for waste).<sup>60</sup> This item shall be interpreted in accordance with the guidelines on consumption of inputs in the production process contained in Annex II.
- (i) The remission or drawback of import charges<sup>58</sup> in excess of those levied on imported inputs that are consumed in the production of the exported product (making normal allowance for waste); provided, however, that in particular cases a firm may use a quantity of home market inputs equal to, and having the same quality and characteristics as, the imported inputs as a substitute for them in order to benefit from this provision if the import and the corresponding export operations both occur within a reasonable time period, not to exceed two years. This item shall be interpreted in accordance with the guidelines on consumption of inputs in the production process contained in Annex II and the guidelines in the determination of substitution drawback systems as export subsidies contained in Annex III.
- (j) The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the cost of exported products or of exchange risk programmes, at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes.
- (k) The grant by governments (or special institutions controlled by and/or acting under the authority of governments) of export credits at rates below those which they actually have to pay for the funds so employed (or would have to pay if they borrowed on international capital markets in order to obtain funds of the same maturity and other credit terms and denominated in the same currency as the export credit), or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms.
- Provided, however, that if a Member is a party to an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members), or if in practice a Member applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement.
- (l) Any other charge on the public account constituting an export subsidy in the sense of Article XVI of GATT 1994.

<sup>60</sup>Paragraph (h) does not apply to value-added tax systems and border-tax adjustment in lieu thereof; the problem of the excessive remission of value-added taxes is exclusively covered by paragraph (g).

## ANNEX II

GUIDELINES ON CONSUMPTION OF INPUTS IN THE PRODUCTION PROCESS<sup>61</sup>

## I

- Indirect tax rebate schemes can allow for exemption, remission or deferral of prior-stage cumulative indirect taxes levied on inputs that are consumed in the production of the exported product (making normal allowance for waste). Similarly, drawback schemes can allow for the remission or drawback of import charges levied on inputs that are consumed in the production of the exported product (making normal allowance for waste).
- The Illustrative List of Export Subsidies in Annex I of this Agreement makes reference to the term "inputs that are consumed in the production of the exported product" in paragraphs (h) and (i). Pursuant to paragraph (h), indirect tax rebate schemes can constitute an export subsidy to the extent that they result in exemption, remission or deferral of prior-stage cumulative indirect taxes in excess of the amount of such taxes actually levied on inputs that are consumed in the production of the exported product. Pursuant to paragraph (i), drawback schemes can constitute an export subsidy to the extent that they result in a remission or drawback of import charges in excess of those actually levied on inputs that are consumed in the production of the exported product. Both paragraphs stipulate that normal allowance for waste must be made in findings regarding consumption of inputs in the production of the exported product. Paragraph (i) also provides for substitution, where appropriate.

## II

- In examining whether inputs are consumed in the production of the exported product, as part of a countervailing duty investigation pursuant to this Agreement, investigating authorities should proceed on the following basis:
- Where it is alleged that an indirect tax rebate scheme, or a drawback scheme, conveys a subsidy by reason of over-rebate or excess drawback of indirect taxes or import charges on inputs consumed in the production of the exported product, the investigating authorities should first determine whether the government of the exporting Member has in place and applies a system or procedure to confirm which inputs are consumed in the production of the exported product and in what amounts. Where such a system or procedure is determined to be applied, the investigating authorities should then examine the system or procedure to see whether it is reasonable, effective for the purpose intended, and based on generally accepted commercial practices in the country of export. The investigating authorities may deem it necessary to carry out, in accordance with paragraph 6 of Article 12, certain practical tests in order to verify information or to satisfy themselves that the system or procedure is being effectively applied.
  - Where there is no such system or procedure, where it is not reasonable, or where it is instituted and considered reasonable but is found not to be applied or not to be applied effectively, a further examination by the exporting Member based on the actual inputs involved would need to be carried out in the context of determining whether an excess payment occurred. If the investigating authorities deemed it necessary, a further examination would be carried out in accordance with paragraph 1.

<sup>61</sup>Inputs consumed in the production process are inputs physically incorporated, energy, fuels and oil used in the production process and catalysts which are consumed in the course of their use to obtain the exported product.

3. Investigating authorities should treat inputs as physically incorporated if such inputs are used in the production process and are physically present in the product exported. The Members note that an input need not be present in the final product in the same form in which it entered the production process.

4. In determining the amount of a particular input that is consumed in the production of the exported product, a "normal allowance for waste" should be taken into account, and such waste should be treated as consumed in the production of the exported product. The term "waste" refers to that portion of a given input which does not serve an independent function in the production process, is not consumed in the production of the exported product (for reasons such as inefficiencies) and is not recovered, used or sold by the same manufacturer.

5. The investigating authority's determination of whether the claimed allowance for waste is "normal" should take into account the production process, the average experience of the industry in the country of export, and other technical factors, as appropriate. The investigating authority should bear in mind that an important question is whether the authorities in the exporting Member have reasonably calculated the amount of waste, when such an amount is intended to be included in the tax or duty rebate or remission.

### ANNEX III

#### GUIDELINES IN THE DETERMINATION OF SUBSTITUTION DRAWBACK SYSTEMS AS EXPORT SUBSIDIES

#### I

Drawback systems can allow for the refund or drawback of import charges on inputs which are consumed in the production process of another product and where the export of this latter product contains domestic inputs having the same quality and characteristics as those substituted for the imported inputs. Pursuant to paragraph (i) of the Illustrative List of Export Subsidies in Annex I, substitution drawback systems can constitute an export subsidy to the extent that they result in an excess drawback of the import charges levied initially on the imported inputs for which drawback is being claimed.

#### II

In examining any substitution drawback system as part of a countervailing duty investigation pursuant to this Agreement, investigating authorities should proceed on the following basis:

1. Paragraph (i) of the Illustrative List stipulates that home market inputs may be substituted for imported inputs in the production of a product for export provided such inputs are equal in quantity to, and have the same quality and characteristics as, the imported inputs being substituted. The existence of a verification system or procedure is important because it enables the government of the exporting Member to ensure and demonstrate that the quantity of inputs for which drawback is claimed does not exceed the quantity of similar products exported, in whatever form, and that there is not drawback of import charges in excess of those originally levied on the imported inputs in question.
2. Where it is alleged that a substitution drawback system conveys a subsidy, the investigating authorities should first proceed to determine whether the government of the exporting Member has in place and applies a verification system or procedure. Where such a system or procedure is determined to be applied, the investigating authorities should then examine the verification procedures to see whether they are reasonable, effective for the purpose intended, and based on generally accepted commercial practices in the country of export. To the extent that the procedures are determined to meet this test and are effectively applied, no subsidy should be presumed to exist. It may be deemed necessary by the investigating authorities to carry out, in accordance with paragraph 6 of Article 12, certain practical tests in order to verify information or to satisfy themselves that the verification procedures are being effectively applied.
3. Where there are no verification procedures, where they are not reasonable, or where such procedures are instituted and considered reasonable but are found not to be actually applied or not applied effectively, there may be a subsidy. In such cases a further examination by the exporting Member based on the actual transactions involved would need to be carried out to determine whether an excess payment occurred. If the investigating authorities deemed it necessary, a further examination would be carried out in accordance with paragraph 2.
4. The existence of a substitution drawback provision under which exporters are allowed to select particular import shipments on which drawback is claimed should not of itself be considered to convey a subsidy.

5. An excess drawback of import charges in the sense of paragraph (i) would be deemed to exist where governments paid interest on any monies refunded under their drawback schemes, to the extent of the interest actually paid or payable.

ANNEX IV  
CALCULATION OF THE TOTAL AD VALOREM SUBSIDIZATION  
(PARAGRAPH 1(A) OF ARTICLE 6)<sup>62</sup>

1. Any calculation of the amount of a subsidy for the purpose of paragraph 1(a) of Article 6 shall be done in terms of the cost to the granting government.
2. Except as provided in paragraphs 3 through 5, in determining whether the overall rate of subsidization exceeds 5 per cent of the value of the product, the value of the product shall be calculated as the total value of the recipient firm's<sup>63</sup> sales in the most recent 12-month period, for which sales data is available, preceding the period in which the subsidy is granted.<sup>64</sup>
3. Where the subsidy is tied to the production or sale of a given product, the value of the product shall be calculated as the total value of the recipient firm's sales of that product in the most recent 12-month period, for which sales data is available, preceding the period in which the subsidy is granted.
4. Where the recipient firm is in a start-up situation, serious prejudice shall be deemed to exist if the overall rate of subsidization exceeds 15 per cent of the total funds invested. For purposes of this paragraph, a start-up period will not extend beyond the first year of production.<sup>65</sup>
5. Where the recipient firm is located in an inflationary economy country, the value of the product shall be calculated as the recipient firm's total sales (or sales of the relevant product, if the subsidy is tied) in the preceding calendar year indexed by the rate of inflation experienced in the 12 months preceding the month in which the subsidy is to be given.
6. In determining the overall rate of subsidization in a given year, subsidies given under different programmes and by different authorities in the territory of a Member shall be aggregated.
7. Subsidies granted prior to the date of entry into force of the WTO Agreement, the benefits of which are allocated to future production, shall be included in the overall rate of subsidization.
8. Subsidies which are non-actionable under relevant provisions of this Agreement shall not be included in the calculation of the amount of a subsidy for the purpose of paragraph 1(a) of Article 6.

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<sup>62</sup>An understanding among Members should be developed, as necessary, on matters which are not specified in this Annex or which need further clarification for the purposes of paragraph 1(a) of Article 6.

<sup>63</sup>The recipient firm is a firm in the territory of the subsidizing Member.

<sup>64</sup>In the case of tax-related subsidies the value of the product shall be calculated as the total value of the recipient firm's sales in the fiscal year in which the tax-related measure was earned.

<sup>65</sup>Start-up situations include instances where financial commitments for product development or construction of facilities to manufacture products benefiting from the subsidy have been made, even though production has not begun.

## ANNEX V

## PROCEDURES FOR DEVELOPING INFORMATION CONCERNING SERIOUS PREJUDICE

1. Every Member shall cooperate in the development of evidence to be examined by a panel in procedures under paragraphs 4 through 6 of Article 7. The parties to the dispute and any third-country Member concerned shall notify to the DSB, as soon as the provisions of paragraph 4 of Article 7 have been invoked, the organization responsible for administration of this provision within its territory and the procedures to be used to comply with requests for information.
2. In cases where matters are referred to the DSB under paragraph 4 of Article 7, the DSB shall, upon request, initiate the procedure to obtain such information from the government of the subsidizing Member as necessary to establish the existence and amount of subsidization, the value of total sales of the subsidized firms, as well as information necessary to analyze the adverse effects caused by the subsidized product.<sup>66</sup> This process may include, where appropriate, presentation of questions to the government of the subsidizing Member and of the complaining Member to collect information, as well as to clarify and obtain elaboration of information available to the parties to a dispute through the notification procedures set forth in Part VII.<sup>67</sup>
3. In the case of effects in third-country markets, a party to a dispute may collect information, including through the use of questions to the government of the third-country Member, necessary to analyse adverse effects, which is not otherwise reasonably available from the complaining Member or the subsidizing Member. This requirement should be administered in such a way as not to impose an unreasonable burden on the third-country Member. In particular, such a Member is not expected to make a market or price analysis specially for that purpose. The information to be supplied is that which is already available or can be readily obtained by this Member (e.g. most recent statistics which have already been gathered by relevant statistical services but which have not yet been published, customs data concerning imports and declared values of the products concerned, etc.). However, if a party to a dispute undertakes a detailed market analysis at its own expense, the task of the person or firm conducting such an analysis shall be facilitated by the authorities of the third-country Member and such a person or firm shall be given access to all information which is not normally maintained confidential by the government.

4. The DSB shall designate a representative to serve the function of facilitating the information-gathering process. The sole purpose of the representative shall be to ensure the timely development of the information necessary to facilitate expeditious subsequent multilateral review of the dispute. In particular, the representative may suggest ways to most efficiently solicit necessary information as well as encourage the cooperation of the parties.

5. The information-gathering process outlined in paragraphs 2 through 4 shall be completed within 60 days of the date on which the matter has been referred to the DSB under paragraph 4 of Article 7. The information obtained during this process shall be submitted to the panel established by the DSB in accordance with the provisions of Part X. This information should include, *inter alia*, data concerning the amount of the subsidy in question (and, where appropriate, the value of total sales of the subsidized firms), prices of the subsidized product, prices of the non-subsidized product, prices of other suppliers to the market, changes in the supply of the subsidized product to the market in question and changes

<sup>66</sup>In cases where the existence of serious prejudice has to be demonstrated.

<sup>67</sup>The information-gathering process by the DSB shall take into account the need to protect information which is by nature confidential or which is provided on a confidential basis by any Member involved in this process.

in market shares. It should also include rebuttal evidence, as well as such supplemental information as the panel deems relevant in the course of reaching its conclusions.

6. If the subsidizing and/or third-country Member fail to cooperate in the information-gathering process, the complaining Member will present its case of serious prejudice, based on evidence available to it, together with facts and circumstances of the non-cooperation of the subsidizing and/or third-country Member. Where information is unavailable due to non-cooperation by the subsidizing and/or third-country Member, the panel may complete the record as necessary relying on best information otherwise available.
7. In making its determination, the panel should draw adverse inferences from instances of non-cooperation by any party involved in the information-gathering process.
8. In making a determination to use either best information available or adverse inferences, the panel shall consider the advice of the DSB representative nominated under paragraph 4 as to the reasonableness of any requests for information and the efforts made by parties to comply with these requests in a cooperative and timely manner.
9. Nothing in the information-gathering process shall limit the ability of the panel to seek such additional information it deems essential to a proper resolution to the dispute, and which was not adequately sought or developed during that process. However, ordinarily the panel should not request additional information to complete the record where the information would support a particular party's position and the absence of that information in the record is the result of unreasonable non-cooperation by that party in the information-gathering process.

## ANNEX VI

PROCEDURES FOR ON-THE-SPOT INVESTIGATIONS PURSUANT TO  
PARAGRAPH 6 OF ARTICLE 12

1. Upon initiation of an investigation, the authorities of the exporting Member and the firms known to be concerned should be informed of the intention to carry out on-the-spot investigations.
2. If in exceptional circumstances it is intended to include non-governmental experts in the investigating team, the firms and the authorities of the exporting Member should be so informed. Such non-governmental experts should be subject to effective sanctions for breach of confidentiality requirements.
3. It should be standard practice to obtain explicit agreement of the firms concerned in the exporting Member before the visit is finally scheduled.
4. As soon as the agreement of the firms concerned has been obtained, the investigating authorities should notify the authorities of the exporting Member of the names and addresses of the firms to be visited and the dates agreed.
5. Sufficient advance notice should be given to the firms in question before the visit is made.
6. Visits to explain the questionnaire should only be made at the request of an exporting firm. In case of such a request the investigating authorities may place themselves at the disposal of the firm; such a visit may only be made if (a) the authorities of the importing Member notify the representatives of the government of the Member in question and (b) the latter do not object to the visit.
7. As the main purpose of the on-the-spot investigation is to verify information provided or to obtain further details, it should be carried out after the response to the questionnaire has been received unless the firm agrees to the contrary and the government of the exporting Member is informed by the investigating authorities of the anticipated visit and does not object to it; further, it should be standard practice prior to the visit to advise the firms concerned of the general nature of the information to be verified and of any further information which needs to be provided, though this should not preclude requests to be made on the spot for further details to be provided in the light of information obtained.
8. Enquiries or questions put by the authorities or firms of the exporting Members and essential to a successful on-the-spot investigation should, whenever possible, be answered before the visit is made.

## ANNEX VII

DEVELOPING COUNTRY MEMBERS REFERRED TO  
IN PARAGRAPH 2(A) OF ARTICLE 27

The developing country Members not subject to the provisions of paragraph 1(a) of Article 3 under the terms of paragraph 2(a) of Article 27 are:

- (a) Least-developed countries designated as such by the United Nations which are Members of the WTO.
- (b) Each of the following developing countries which are Members of the WTO shall be subject to the provisions which are applicable to other developing country Members according to paragraph 2(b) of Article 27 when GNP per capita has reached \$1,000 per annum<sup>68</sup>: Bolivia, Cameroon, Congo, Côte d'Ivoire, Dominican Republic, Egypt, Ghana, Guatemala, Guyana, India, Indonesia, Kenya, Morocco, Nicaragua, Nigeria, Pakistan, Philippines, Senegal, Sri Lanka and Zimbabwe.

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<sup>68</sup>The inclusion of developing country Members in the list in paragraph (b) is based on the most recent data from the World Bank on GNP per capita.



## **Agreement on Safeguards, 1994**

## AGREEMENT ON SAFEGUARDS

*Members,*

*Having in mind the overall objective of the Members to improve and strengthen the international trading system based on GATT 1994;*

*Recognizing the need to clarify and reinforce the disciplines of GATT 1994, and specifically those of its Article XIX (Emergency Action on Imports of Particular Products), to re-establish multilateral control over safeguards and eliminate measures that escape such control;*

*Recognizing the importance of structural adjustment and the need to enhance rather than limit competition in international markets; and*

*Recognizing further that, for these purposes, a comprehensive agreement, applicable to all Members and based on the basic principles of GATT 1994, is called for;*

Hereby *agree* as follows:

### *Article 1*

#### *General Provision*

This Agreement establishes rules for the application of safeguard measures which shall be understood to mean those measures provided for in Article XIX of GATT 1994.

### *Article 2*

#### *Conditions*

1. A Member<sup>1</sup> may apply a safeguard measure to a product only if that Member has determined, pursuant to the provisions set out below, that such product is being imported into its territory in such increased quantities, absolute or relative to domestic production, and under such conditions as to cause or threaten to cause serious injury to the domestic industry that produces like or directly competitive products.

2. Safeguard measures shall be applied to a product being imported irrespective of its source.

### *Article 3*

#### *Investigation*

<sup>1</sup> A customs union may apply a safeguard measure as a single unit or on behalf of a member State. When a customs union applies a safeguard measure as a single unit, all the requirements for the determination of serious injury or threat thereof under this Agreement shall be based on the conditions existing in the customs union as a whole. When a safeguard measure is applied on behalf of a member State, all the requirements for the determination of serious injury or threat thereof shall be based on the conditions existing in that member State and the measure shall be limited to that member State. Nothing in this Agreement prejudices the interpretation of the relationship between Article XIX and paragraph 8 of Article XXIV of GATT 1994.

1. A Member may apply a safeguard measure only following an investigation by the competent authorities of that Member pursuant to procedures previously established and made public in consonance with Article X of GATT 1994. This investigation shall include reasonable public notice to all interested parties and public hearings or other appropriate means in which importers, exporters and other interested parties could present evidence and their views, including the opportunity to respond to the presentations of other parties and to submit their views, *inter alia*, as to whether or not the application of a safeguard measure would be in the public interest. The competent authorities shall publish a report setting forth their findings and reasoned conclusions reached on all pertinent issues of fact and law.

2. Any information which is by nature confidential or which is provided on a confidential basis shall, upon cause being shown, be treated as such by the competent authorities. Such information shall not be disclosed without permission of the party submitting it. Parties providing confidential information may be requested to furnish non-confidential summaries thereof or, if such parties indicate that such information cannot be summarized, the reasons why a summary cannot be provided. However, if the competent authorities find that a request for confidentiality is not warranted and if the party concerned is either unwilling to make the information public or to authorize its disclosure in generalized or summary form, the authorities may disregard such information unless it can be demonstrated to their satisfaction from appropriate sources that the information is correct.

### *Article 4*

#### *Determination of Serious Injury or Threat Thereof*

1. For the purposes of this Agreement:

- (a) "serious injury" shall be understood to mean a significant overall impairment in the position of a domestic industry;
- (b) "threat of serious injury" shall be understood to mean serious injury that is clearly imminent, in accordance with the provisions of paragraph 2. A determination of the existence of a threat of serious injury shall be based on facts and not merely on allegation, conjecture or remote possibility; and
- (c) in determining injury or threat thereof, a "domestic industry" shall be understood to mean the producers as a whole of the like or directly competitive products operating within the territory of a Member, or those whose collective output of the like or directly competitive products constitutes a major proportion of the total domestic production of those products.

2. (a) In the investigation to determine whether increased imports have caused or are threatening to cause serious injury to a domestic industry under the terms of this Agreement, the competent authorities shall evaluate all relevant factors of an objective and quantifiable nature having a bearing on the situation of that industry, in particular, the rate and amount of the increase in imports of the product concerned in absolute and relative terms, the share of the domestic market taken by increased imports, changes in the level of sales, production, productivity, capacity utilization, profits and losses, and employment.

(b) The determination referred to in subparagraph (a) shall not be made unless this investigation demonstrates, on the basis of objective evidence, the existence of the causal link between increased imports of the product concerned and serious injury or threat thereof. When factors other than increased imports are causing injury to the

domestic industry at the same time, such injury shall not be attributed to increased imports.

- (c) The competent authorities shall publish promptly, in accordance with the provisions of Article 3, a detailed analysis of the case under investigation as well as a demonstration of the relevance of the factors examined.

#### Article 5

##### *Application of Safeguard Measures*

1. A Member shall apply safeguard measures only to the extent necessary to prevent or remedy serious injury and to facilitate adjustment. If a quantitative restriction is used, such a measure shall not reduce the quantity of imports below the level of a recent period which shall be the average of imports in the last three representative years for which statistics are available, unless clear justification is given that a different level is necessary to prevent or remedy serious injury. Members should choose measures most suitable for the achievement of these objectives.
2. (a) In cases in which a quota is allocated among supplying countries, the Member applying the restrictions may seek agreement with respect to the allocation of shares in the quota with all other Members having a substantial interest in supplying the product concerned. In cases in which this method is not reasonably practicable, the Member concerned shall allot to Members having a substantial interest in supplying the product shares based upon the proportions, supplied by such Members during a previous representative period, of the total quantity or value of imports of the product, due account being taken of any special factors which may have affected or may be affecting the trade in the product.

- (b) A Member may depart from the provisions in subparagraph (a) provided that consultations under paragraph 3 of Article 12 are conducted under the auspices of the Committee on Safeguards provided for in paragraph 1 of Article 13 and that clear demonstration is provided to the Committee that (i) imports from certain Members have increased in disproportionate percentage in relation to the total increase of imports of the product concerned in the representative period, (ii) the reasons for the departure from the provisions in subparagraph (a) are justified, and (iii) the conditions of such departure are equitable to all suppliers of the product concerned. The duration of any such measure shall not be extended beyond the initial period under paragraph 1 of Article 7. The departure referred to above shall not be permitted in the case of threat of serious injury.

#### Article 6

##### *Provisional Safeguard Measures*

In critical circumstances where delay would cause damage which it would be difficult to repair, a Member may take a provisional safeguard measure pursuant to a preliminary determination that there is clear evidence that increased imports have caused or are threatening to cause serious injury. The duration of the provisional measure shall not exceed 200 days, during which period the pertinent requirements of Articles 2 through 7 and 12 shall be met. Such measures should take the form of tariff increases to be promptly refunded if the subsequent investigation referred to in paragraph 2 of Article 4 does not determine that increased imports have caused or threatened to cause

serious injury to a domestic industry. The duration of any such provisional measure shall be counted as a part of the initial period and any extension referred to in paragraphs 1, 2 and 3 of Article 7.

#### Article 7

##### *Duration and Review of Safeguard Measures*

1. A Member shall apply safeguard measures only for such period of time as may be necessary to prevent or remedy serious injury and to facilitate adjustment. The period shall not exceed four years, unless it is extended under paragraph 2.
2. The period mentioned in paragraph 1 may be extended provided that the competent authorities of the importing Member have determined, in conformity with the procedures set out in Articles 2, 3, 4 and 5, that the safeguard measure continues to be necessary to prevent or remedy serious injury and that there is evidence that the industry is adjusting, and provided that the pertinent provisions of Articles 8 and 12 are observed.
3. The total period of application of a safeguard measure including the period of application of any provisional measure, the period of initial application and any extension thereof, shall not exceed eight years.
4. In order to facilitate adjustment in a situation where the expected duration of a safeguard measure as notified under the provisions of paragraph 1 of Article 12 is over one year, the Member applying the measure shall progressively liberalize it at regular intervals during the period of application. If the duration of the measure exceeds three years, the Member applying such a measure shall review the situation not later than the mid-term of the measure and, if appropriate, withdraw it or increase the pace of liberalization. A measure extended under paragraph 2 shall not be more restrictive than it was at the end of the initial period, and should continue to be liberalized.
5. No safeguard measure shall be applied again to the import of a product which has been subject to such a measure, taken after the date of entry into force of the WTO Agreement, for a period of time equal to that during which such measure had been previously applied, provided that the period of non-application is at least two years.
6. Notwithstanding the provisions of paragraph 5, a safeguard measure with a duration of 180 days or less may be applied again to the import of a product if:

- (a) at least one year has elapsed since the date of introduction of a safeguard measure on the import of that product; and
- (b) such a safeguard measure has not been applied on the same product more than twice in the five-year period immediately preceding the date of introduction of the measure.

#### Article 8

##### *Level of Concessions and Other Obligations*

1. A Member proposing to apply a safeguard measure or seeking an extension of a safeguard measure shall endeavour to maintain a substantially equivalent level of concessions and other obligations to that existing under GATT 1994 between it and the exporting Members which would be affected by such a measure, in accordance with the provisions of paragraph 3 of Article 12. To

achieve this objective, the Members concerned may agree on any adequate means of trade compensation for the adverse effects of the measure on their trade.

2. If no agreement is reached within 30 days in the consultations under paragraph 3 of Article 12, then the affected exporting Members shall be free, not later than 90 days after the measure is applied, to suspend, upon the expiration of 30 days from the day on which written notice of such suspension is received by the Council for Trade in Goods, the application of substantially equivalent concessions or other obligations under GATT 1994, to the trade of the Member applying the safeguard measure, the suspension of which the Council for Trade in Goods does not disapprove.

3. The right of suspension referred to in paragraph 2 shall not be exercised for the first three years that a safeguard measure is in effect, provided that the safeguard measure has been taken as a result of an absolute increase in imports and that such a measure conforms to the provisions of this Agreement.

#### *Article 9*

##### *Developing Country Members*

1. Safeguard measures shall not be applied against a product originating in a developing country Member as long as its share of imports of the product concerned in the importing Member does not exceed 3 per cent, provided that developing country Members with less than 3 per cent import share collectively account for not more than 9 per cent of total imports of the product concerned.<sup>2</sup>

2. A developing country Member shall have the right to extend the period of application of a safeguard measure for a period of up to two years beyond the maximum period provided for in paragraph 3 of Article 7. Notwithstanding the provisions of paragraph 5 of Article 7, a developing country Member shall have the right to apply a safeguard measure again to the import of a product which has been subject to such a measure, taken after the date of entry into force of the WTO Agreement, after a period of time equal to half that during which such a measure has been previously applied, provided that the period of non-application is at least two years.

#### *Article 10*

##### *Pre-existing Article XIX Measures*

Members shall terminate all safeguard measures taken pursuant to Article XIX of GATT 1947 that were in existence on the date of entry into force of the WTO Agreement not later than eight years after the date on which they were first applied or five years after the date of entry into force of the WTO Agreement, whichever comes later.

#### *Article 11*

##### *Prohibition and Elimination of Certain Measures*

1. (a) A Member shall not take or seek any emergency action on imports of particular products as set forth in Article XIX of GATT 1994 unless such action conforms with the provisions of that Article applied in accordance with this Agreement.

<sup>2</sup> A Member shall immediately notify an action taken under paragraph 1 of Article 9 to the Committee on Safeguards.

(b) Furthermore, a Member shall not seek, take or maintain any voluntary export restraints, orderly marketing arrangements or any other similar measures on the export or the import side.<sup>3, 4</sup> These include actions taken by a single Member as well as actions under agreements, arrangements and understandings entered into by two or more Members. Any such measure in effect on the date of entry into force of the WTO Agreement shall be brought into conformity with this Agreement or phased out in accordance with paragraph 2.

(c) This Agreement does not apply to measures sought, taken or maintained by a Member pursuant to provisions of GATT 1994 other than Article XIX, and Multilateral Trade Agreements in Annex 1A other than this Agreement, or pursuant to protocols and agreements or arrangements concluded within the framework of GATT 1994.

2. The phasing out of measures referred to in paragraph 1(b) shall be carried out according to timetables to be presented to the Committee on Safeguards by the Members concerned not later than 180 days after the date of entry into force of the WTO Agreement. These timetables shall provide for all measures referred to in paragraph 1 to be phased out or brought into conformity with this Agreement within a period not exceeding four years after the date of entry into force of the WTO Agreement, subject to not more than one specific measure per importing Member<sup>5</sup>, the duration of which shall not extend beyond 31 December 1999. Any such exception must be mutually agreed between the Members directly concerned and notified to the Committee on Safeguards for its review and acceptance within 90 days of the entry into force of the WTO Agreement. The Annex to this Agreement indicates a measure which has been agreed as falling under this exception.

3. Members shall not encourage or support the adoption or maintenance by public and private enterprises of non-governmental measures equivalent to those referred to in paragraph 1.

#### *Article 12*

##### *Notification and Consultation*

1. A Member shall immediately notify the Committee on Safeguards upon:

- (a) initiating an investigatory process relating to serious injury or threat thereof and the reasons for it;
- (b) making a finding of serious injury or threat thereof caused by increased imports; and
- (c) taking a decision to apply or extend a safeguard measure.

2. In making the notifications referred to in paragraphs 1(b) and 1(c), the Member proposing to apply or extend a safeguard measure shall provide the Committee on Safeguards with all pertinent information, which shall include evidence of serious injury or threat thereof caused by increased

<sup>3</sup> An import quota applied as a safeguard measure in conformity with the relevant provisions of GATT 1994 and this Agreement may, by mutual agreement, be administered by the exporting Member.

<sup>4</sup> Examples of similar measures include export moderation, export-price or import-price monitoring systems, export or import surveillance, compulsory import cartels and discretionary export or import licensing schemes, any of which afford protection.

<sup>5</sup> The only such exception to which the European Communities is entitled is indicated in the Annex to this Agreement.

imports, precise description of the product involved and the proposed measure, proposed date of introduction, expected duration and timetable for progressive liberalization. In the case of an extension of a measure, evidence that the industry concerned is adjusting shall also be provided. The Council for Trade in Goods or the Committee on Safeguards may request such additional information as they may consider necessary from the Member proposing to apply or extend the measure.

3. A Member proposing to apply or extend a safeguard measure shall provide adequate opportunity for prior consultations with those Members having a substantial interest as exporters of the product concerned, with a view to, *inter alia*, reviewing the information provided under paragraph 2, exchanging views on the measure and reaching an understanding on ways to achieve the objective set out in paragraph 1 of Article 8.

4. A Member shall make a notification to the Committee on Safeguards before taking a provisional safeguard measure referred to in Article 6. Consultations shall be initiated immediately after the measure is taken.

5. The results of the consultations referred to in this Article, as well as the results of mid-term reviews referred to in paragraph 4 of Article 7, any form of compensation referred to in paragraph 1 of Article 8, and proposed suspensions of concessions and other obligations referred to in paragraph 2 of Article 8, shall be notified immediately to the Council for Trade in Goods by the Members concerned.

6. Members shall notify promptly the Committee on Safeguards of their laws, regulations and administrative procedures relating to safeguard measures as well as any modifications made to them.

7. Members maintaining measures described in Article 10 and paragraph 1 of Article 11 which exist on the date of entry into force of the WTO Agreement shall notify such measures to the Committee on Safeguards not later than 60 days after the date of entry into force of the WTO Agreement.

8. Any Member may notify the Committee on Safeguards of all laws, regulations, administrative procedures and any measures or actions dealt with in this Agreement that have not been notified by other Members that are required by this Agreement to make such notifications.

9. Any Member may notify the Committee on Safeguards of any non-governmental measures referred to in paragraph 3 of Article 11.

10. All notifications to the Council for Trade in Goods referred to in this Agreement shall normally be made through the Committee on Safeguards.

11. The provisions on notification in this Agreement shall not require any Member to disclose confidential information the disclosure of which would impede law enforcement or otherwise be contrary to the public interest or would prejudice the legitimate commercial interests of particular enterprises, public or private.

#### *Article 13*

##### *Surveillance*

1. A Committee on Safeguards is hereby established, under the authority of the Council for Trade in Goods, which shall be open to the participation of any Member indicating its wish to serve on it. The Committee will have the following functions:

- (a) to monitor, and report annually to the Council for Trade in Goods on, the general implementation of this Agreement and make recommendations towards its improvement;
- (b) to find, upon request of an affected Member, whether or not the procedural requirements of this Agreement have been complied with in connection with a safeguard measure, and report its findings to the Council for Trade in Goods;
- (c) to assist Members, if they so request, in their consultations under the provisions of this Agreement;
- (d) to examine measures covered by Article 10 and paragraph 1 of Article 11, monitor the phase-out of such measures and report as appropriate to the Council for Trade in Goods;
- (e) to review, at the request of the Member taking a safeguard measure, whether proposals to suspend concessions or other obligations are "substantially equivalent", and report as appropriate to the Council for Trade in Goods;
- (f) to receive and review all notifications provided for in this Agreement and report as appropriate to the Council for Trade in Goods; and
- (g) to perform any other function connected with this Agreement that the Council for Trade in Goods may determine.

2. To assist the Committee in carrying out its surveillance function, the Secretariat shall prepare annually a factual report on the operation of this Agreement based on notifications and other reliable information available to it.

#### *Article 14*

##### *Dispute Settlement*

The provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding shall apply to consultations and the settlement of disputes arising under this Agreement.

ANNEX

EXCEPTION REFERRED TO IN PARAGRAPH 2 OF ARTICLE 11

Members concerned	Product	Termination
EC/Japan	Passenger cars, off road light commercial vehicles, light trucks (up to 5 tonnes), and the same vehicles in wholly knocked-down form (CKD sets).	31 December 1999

**Understanding on Rules and Procedures Governing  
the Settlement of Disputes, 1994**

**UNDERSTANDING ON RULES AND PROCEDURES GOVERNING THE SETTLEMENT OF DISPUTES**

**("Dispute Settlement Understanding" or "DSU")**

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Members hereby agree as follows:

**Article 1: Coverage and Application**

1. The rules and procedures of this Understanding shall apply to disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1 to this Understanding (referred to in this Understanding as the "covered agreements"). The rules and procedures of this Understanding shall also apply to consultations and the settlement of disputes between Members concerning their rights and obligations under the provisions of the Agreement Establishing the World Trade Organization (referred to in this Understanding as the "WTO Agreement") and of this Understanding taken in isolation or in combination with any other covered agreement.
2. The rules and procedures of this Understanding shall apply subject to such special or additional rules and procedures on dispute settlement contained in the covered agreements as are identified in Appendix 2 to this Understanding. To the extent that there is a difference between the rules and procedures of this Understanding and the special or additional rules and procedures set forth in Appendix 2, the special or additional rules and procedures in Appendix 2 shall prevail. In disputes involving rules and procedures under more than one covered agreement, if there is a conflict between special or additional rules and procedures of such agreements under review, and where the parties to the dispute cannot agree on rules and procedures within 20 days of the establishment of the panel, the Chairman of the Dispute Settlement Body provided for in paragraph 1 of Article 2 (referred to in this Understanding as the "DSB"), in consultation with the parties to the dispute, shall determine the rules and procedures to be followed within 10 days after a request by either Member. The Chairman shall be guided by the principle that special or additional rules and procedures should be used where possible, and the rules and procedures set out in this Understanding should be used to the extent necessary to avoid conflict.

**Article 2: Administration**

1. The Dispute Settlement Body is hereby established to administer these rules and procedures and, except as otherwise provided in a covered agreement, the consultation and dispute settlement provisions of the covered agreements. Accordingly, the DSB shall have the authority to establish panels, adopt panel and Appellate Body reports, maintain surveillance of implementation of rulings and recommendations, and authorize suspension of concessions and other obligations under the covered agreements. With respect to disputes arising under a covered agreement which is a Plurilateral Trade Agreement, the term "Member" as used herein shall refer only to those Members that are parties to the relevant Plurilateral Trade Agreement. Where the DSB administers the dispute settlement provisions of a Plurilateral Trade Agreement, only those Members that are parties to that Agreement may participate in decisions or actions taken by the DSB with respect to that dispute.
2. The DSB shall inform the relevant WTO Councils and Committees of any developments in disputes related to provisions of the respective covered agreements.

3. The DSB shall meet as often as necessary to carry out its functions within the time-frames provided in this Understanding.
4. Where the rules and procedures of this Understanding provide for the DSB to take a decision, it shall do so by consensus.<sup>1</sup>

### Article 3: General Provisions

1. Members affirm their adherence to the principles for the management of disputes heretofore applied under Articles XXII and XXIII of GATT 1947, and the rules and procedures as further elaborated and modified herein.
2. The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system. The Members recognize that it serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law. Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements.
3. The prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is essential to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members.
4. Recommendations or rulings made by the DSB shall be aimed at achieving a satisfactory settlement of the matter in accordance with the rights and obligations under this Understanding and under the covered agreements.
5. All solutions to matters formally raised under the consultation and dispute settlement provisions of the covered agreements, including arbitration awards, shall be consistent with those agreements and shall not nullify or impair benefits accruing to any Member under those agreements, nor impede the attainment of any objective of those agreements.
6. Mutually agreed solutions to matters formally raised under the consultation and dispute settlement provisions of the covered agreements shall be notified to the DSB and the relevant Councils and Committees, where any Member may raise any point relating thereto.

7. Before bringing a case, a Member shall exercise its judgement as to whether action under these procedures would be fruitful. The aim of the dispute settlement mechanism is to secure a positive solution to a dispute. A solution mutually acceptable to the parties to a dispute and consistent with the covered agreements is clearly to be preferred. In the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements. The provision of compensation should be resorted to only if the immediate withdrawal of the measure is impracticable and as a temporary measure pending the withdrawal of the measure which is inconsistent with a covered agreement. The last resort which this Understanding provides to the Member invoking the

dispute settlement procedures is the possibility of suspending the application of concessions or other obligations under the covered agreements on a discriminatory basis vis-à-vis the other Member, subject to authorization by the DSB of such measures.

8. In cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of nullification or impairment. This means that there is normally a presumption that a breach of the rules has an adverse impact on other Members parties to that covered agreement, and in such cases, it shall be up to the Member against whom the complaint has been brought to rebut the charge.
9. The provisions of this Understanding are without prejudice to the rights of Members to seek authoritative interpretation of provisions of a covered agreement through decision-making under the WTO Agreement or a covered agreement which is a Plurilateral Trade Agreement.
10. It is understood that requests for conciliation and the use of the dispute settlement procedures should not be intended or considered as contentious acts and that, if a dispute arises, all Members will engage in these procedures in good faith in an effort to resolve the dispute. It is also understood that complaints and counter-complaints in regard to distinct matters should not be linked.
11. This Understanding shall be applied only with respect to new requests for consultations under the consultation provisions of the covered agreements made on or after the date of entry into force of the WTO Agreement. With respect to disputes for which the request for consultations was made under GATT 1947 or under any other predecessor agreement to the covered agreements before the date of entry into force of the WTO Agreement, the relevant dispute settlement rules and procedures in effect immediately prior to the date of entry into force of the WTO Agreement shall continue to apply.<sup>2</sup>
12. Notwithstanding paragraph 11, if a complaint based on any of the covered agreements is brought by a developing country Member against a developed country Member, the complaining party shall have the right to invoke, as an alternative to the provisions contained in Articles 4, 5, 6 and 12 of this Understanding, the corresponding provisions of the Decision of 5 April 1966 (BISD 14S/18), except that where the Panel considers that the time-frame provided for in paragraph 7 of that Decision is insufficient to provide its report and with the agreement of the complaining party, that time-frame may be extended. To the extent that there is a difference between the rules and procedures of Articles 4, 5, 6 and 12 and the corresponding rules and procedures of the Decision, the latter shall prevail.

### Article 4: Consultations

1. Members affirm their resolve to strengthen and improve the effectiveness of the consultation procedures employed by Members.
2. Each Member undertakes to accord sympathetic consideration to and afford adequate opportunity for consultation regarding any representations made by another Member

<sup>1</sup>The DSB shall be deemed to have decided by consensus on a matter submitted for its consideration, if no Member, present at the meeting of the DSB when the decision is taken, formally objects to the proposed decision.

<sup>2</sup>This paragraph shall also be applied to disputes on which panel reports have not been adopted or fully implemented.

concerning measures affecting the operation of any covered agreement taken within the territory of the former.<sup>3</sup>

3. If a request for consultations is made pursuant to a covered agreement, the Member to which the request is made shall, unless otherwise mutually agreed, reply to the request within 10 days after the date of its receipt and shall enter into consultations in good faith within a period of no more than 30 days after the date of receipt of the request, with a view to reaching a mutually satisfactory solution. If the Member does not respond within 10 days after the date of receipt of the request, or does not enter into consultations within a period of no more than 30 days, or a period otherwise mutually agreed, after the date of receipt of the request, then the Member that requested the holding of consultations may proceed directly to request the establishment of a panel.

4. All such requests for consultations shall be notified to the DSB and the relevant Councils and Committees by the Member which requests consultations. Any request for consultations shall be submitted in writing and shall give the reasons for the request, including identification of the measures at issue and an indication of the legal basis for the complaint.

5. In the course of consultations in accordance with the provisions of a covered agreement, before resorting to further action under this Understanding, Members should attempt to obtain satisfactory adjustment of the matter.

6. Consultations shall be confidential, and without prejudice to the rights of any Member in any further proceedings.

7. If the consultations fail to settle a dispute within 60 days after the date of receipt of the request for consultations, the complaining party may request the establishment of a panel. The complaining party may request a panel during the 60-day period if the consulting parties jointly consider that consultations have failed to settle the dispute.

8. In cases of urgency, including those which concern perishable goods, Members shall enter into consultations within a period of no more than 10 days after the date of receipt of the request. If the consultations have failed to settle the dispute within a period of 20 days after the date of receipt of the request, the complaining party may request the establishment of a panel.

9. In cases of urgency, including those which concern perishable goods, the parties to the dispute, panels and the Appellate Body shall make every effort to accelerate the proceedings to the greatest extent possible.

10. During consultations Members should give special attention to the particular problems and interests of developing country Members.

11. Whenever a Member other than the consulting Members considers that it has a substantial trade interest in consultations being held pursuant to paragraph 1 of Article XXII of GATT 1994, paragraph 1 of Article XXII of GATS, or the corresponding provisions in other covered agreements<sup>4</sup>, such Member may notify the consulting Members and the DSB, within

<sup>3</sup>Where the provisions of any other covered agreement concerning measures taken by regional or local governments or authorities within the territory of a Member contain provisions different from the provisions of this paragraph, the provisions of such other covered agreement shall prevail.

<sup>4</sup>The corresponding consultation provisions in the covered agreements are listed hereunder: Agreement on Agriculture, Article 19; Agreement on the Application of Sanitary and Phytosanitary Measures, paragraph 1 of Article 11; Agreement on Textiles and Clothing, paragraph 4 of Article 8; Agreement on Technical Barriers to Trade, paragraph 1 of Article 14; Agreement on Trade-Related Investment

10 days after the date of the circulation of the request for consultations under said Article, of its desire to be joined in the consultations. Such Member shall be joined in the consultations, provided that the Member to which the request for consultations was addressed agrees that the claim of substantial interest is well-founded. In that event they shall so inform the DSB. If the request to be joined in the consultations is not accepted, the applicant Member shall be free to request consultations under paragraph 1 of Article XXII or paragraph 1 of Article XXIII of GATT 1994, paragraph 1 of Article XXII or paragraph 1 of Article XXIII of GATS, or the corresponding provisions in other covered agreements.

### Article 5: Good Offices, Conciliation and Mediation

1. Good offices, conciliation and mediation are procedures that are undertaken voluntarily if the parties to the dispute so agree.

2. Proceedings involving good offices, conciliation and mediation, and in particular positions taken by the parties to the dispute during these proceedings, shall be confidential, and without prejudice to the rights of either party in any further proceedings under these procedures.

3. Good offices, conciliation or mediation may be requested at any time by any party to a dispute. They may begin at any time and be terminated at any time. Once procedures for good offices, conciliation or mediation are terminated, a complaining party may then proceed with a request for the establishment of a panel.

4. When good offices, conciliation or mediation are entered into within 60 days after the date of receipt of a request for consultations, the complaining party must allow a period of 60 days after the date of receipt of the request for consultations before requesting the establishment of a panel. The complaining party may request the establishment of a panel during the 60-day period if the parties to the dispute jointly consider that the good offices, conciliation or mediation process has failed to settle the dispute.

5. If the parties to a dispute agree, procedures for good offices, conciliation or mediation may continue while the panel process proceeds.

6. The Director-General may, acting in an *ex officio* capacity, offer good offices, conciliation or mediation with the view to assisting Members to settle a dispute.

### Article 6: Establishment of Panels

1. If the complaining party so requests, a panel shall be established at the latest at the DSB meeting following that at which the request first appears as an item on the DSB's agenda, unless at that meeting the DSB decides by consensus not to establish a panel.<sup>5</sup>

Measures, Article 8; Agreement on Implementation of Article VI of GATT 1994, paragraph 2 of Article 17; Agreement on Implementation of Article VII of GATT 1994, paragraph 2 of Article 19; Agreement on Preshipment Inspection, Article 7; Agreement on Rules of Origin, Article 7; Agreement on Import Licensing Procedures, Article 6; Agreement on Subsidies and Countervailing Measures, Article 30; Agreement on Safeguards, Article 14; Agreement on Trade-Related Aspects of Intellectual Property Rights, Article 64.1; and any corresponding consultation provisions in Plurilateral Trade Agreements as determined by the competent bodies of each Agreement and as notified to the DSB.

<sup>5</sup>If the complaining party so requests, a meeting of the DSB shall be convened for this purpose within 15 days of the request, provided that at least 10 days' advance notice of the meeting is given.

2. The request for the establishment of a panel shall be made in writing. It shall indicate whether consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly. In case the applicant requests the establishment of a panel with other than standard terms of reference, the written request shall include the proposed text of special terms of reference.

#### **Article 7: Terms of Reference of Panels**

1. Panels shall have the following terms of reference unless the parties to the dispute agree otherwise within 20 days from the establishment of the panel:

"To examine, in the light of the relevant provisions in (name of the covered agreement(s) cited by the parties to the dispute), the matter referred to the DSB by (name of party) in document ... and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in that/those agreement(s)."

2. Panels shall address the relevant provisions in any covered agreement or agreements cited by the parties to the dispute.

3. In establishing a panel, the DSB may authorize its Chairman to draw up the terms of reference of the panel in consultation with the parties to the dispute, subject to the provisions of paragraph 1. The terms of reference thus drawn up shall be circulated to all Members. If other than standard terms of reference are agreed upon, any Member may raise any point relating thereto in the DSB.

#### **Article 8: Composition of Panels**

1. Panels shall be composed of well-qualified governmental and/or non-governmental individuals, including persons who have served on or presented a case to a panel, served as a representative of a Member or of a contracting party to GATT 1947 or as a representative to the Council or Committee of any covered agreement or its predecessor agreement, or in the Secretariat, taught or published on international trade law or policy, or served as a senior trade policy official of a Member.

2. Panel members should be selected with a view to ensuring the independence of the members, a sufficiently diverse background and a wide spectrum of experience.

3. Citizens of Members whose governments<sup>6</sup> are parties to the dispute or third parties as defined in paragraph 2 of Article 10 shall not serve on a panel concerned with that dispute, unless the parties to the dispute agree otherwise.

4. To assist in the selection of panelists, the Secretariat shall maintain an indicative list of governmental and non-governmental individuals possessing the qualifications outlined in paragraph 1, from which panelists may be drawn as appropriate. That list shall include the roster of non-governmental panelists established on 30 November 1984 (BISD 31S/9), and other rosters and indicative lists established under any of the covered agreements, and shall retain the names of persons on those rosters and indicative lists at the time of entry into force of the WTO Agreement. Members may periodically suggest names of governmental and non-governmental individuals for inclusion on the indicative list, providing relevant information on their knowledge of international trade and of the sectors or subject matter of the covered agreements, and those names shall be added to the list upon approval by the DSB. For each of the individuals on the list, the list shall indicate specific areas of experience or expertise of the individuals in the sectors or subject matter of the covered agreements.

5. Panels shall be composed of three panelists unless the parties to the dispute agree, within 10 days from the establishment of the panel, to a panel composed of five panelists. Members shall be informed promptly of the composition of the panel.

6. The Secretariat shall propose nominations for the panel to the parties to the dispute. The parties to the dispute shall not oppose nominations except for compelling reasons.

7. If there is no agreement on the panelists within 20 days after the date of the establishment of a panel, at the request of either party, the Director-General, in consultation with the Chairman of the DSB and the Chairman of the relevant Council or Committee, shall determine the composition of the panel by appointing the panelists whom the Director-General considers most appropriate in accordance with any relevant special or additional rules or procedures of the covered agreement or covered agreements which are at issue in the dispute, after consulting with the parties to the dispute. The Chairman of the DSB shall inform the Members of the composition of the panel thus formed no later than 10 days after the date the Chairman receives such a request.

8. Members shall undertake, as a general rule, to permit their officials to serve as panelists.

9. Panelists shall serve in their individual capacities and not as government representatives, nor as representatives of any organization. Members shall therefore not give them instructions nor seek to influence them as individuals with regard to matters before a panel.

10. When a dispute is between a developing country Member and a developed country Member the panel shall, if the developing country Member so requests, include at least one panelist from a developing country Member.

11. Panelists' expenses, including travel and subsistence allowance, shall be met from the WTO budget in accordance with criteria to be adopted by the General Council, based on recommendations of the Committee on Budget, Finance and Administration.

<sup>6</sup>In the case where customs unions or common markets are parties to a dispute, this provision applies to citizens of all member countries of the customs unions or common markets.

### Article 9: Procedures for Multiple Complainants

1. Where more than one Member requests the establishment of a panel related to the same matter, a single panel may be established to examine these complaints taking into account the rights of all Members concerned. A single panel should be established to examine such complaints whenever feasible.
2. The single panel shall organize its examination and present its findings to the DSB in such a manner that the rights which the parties to the dispute would have enjoyed had separate panels examined the complaints are in no way impaired. If one of the parties to the dispute so requests, the panel shall submit separate reports on the dispute concerned. The written submissions by each of the complainants shall be made available to the other complainants, and each complainant shall have the right to be present when any one of the other complainants presents its views to the panel.
3. If more than one panel is established to examine the complaints related to the same matter, to the greatest extent possible the same persons shall serve as panelists on each of the separate panels and the timetable for the panel process in such disputes shall be harmonized.

### Article 10: Third Parties

1. The interests of the parties to a dispute and those of other Members under a covered agreement at issue in the dispute shall be fully taken into account during the panel process.
2. Any Member having a substantial interest in a matter before a panel and having notified its interest to the DSB (referred to in this Understanding as a "third party") shall have an opportunity to be heard by the panel and to make written submissions to the panel. These submissions shall also be given to the parties to the dispute and shall be reflected in the panel report.
3. Third parties shall receive the submissions of the parties to the dispute to the first meeting of the panel.

4. If a third party considers that a measure already the subject of a panel proceeding nullifies or impairs benefits accruing to it under any covered agreement, that Member may have recourse to normal dispute settlement procedures under this Understanding. Such a dispute shall be referred to the original panel wherever possible.

### Article 11: Function of Panels

The function of panels is to assist the DSB in discharging its responsibilities under this Understanding and the covered agreements. Accordingly, a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements. Panels should consult regularly with the parties to the dispute and give them adequate opportunity to develop a mutually satisfactory solution.

### Article 12: Panel Procedures

1. Panels shall follow the Working Procedures in Appendix 3 unless the panel decides otherwise after consulting the parties to the dispute.
2. Panel procedures should provide sufficient flexibility so as to ensure high-quality panel reports, while not unduly delaying the panel process.
3. After consulting the parties to the dispute, the panelists shall, as soon as practicable and whenever possible within one week after the composition and terms of reference of the panel have been agreed upon, fix the timetable for the panel process, taking into account the provisions of paragraph 9 of Article 4, if relevant.
4. In determining the timetable for the panel process, the panel shall provide sufficient time for the parties to the dispute to prepare their submissions.
5. Panels should set precise deadlines for written submissions by the parties and the parties should respect those deadlines.
6. Each party to the dispute shall deposit its written submissions with the Secretariat for immediate transmission to the panel and to the other party or parties to the dispute. The complaining party shall submit its first submission in advance of the responding party's first submission unless the panel decides, in fixing the timetable referred to in paragraph 3 and after consultations with the parties to the dispute, that the parties should submit their first submissions simultaneously. When there are sequential arrangements for the deposit of first submissions, the panel shall establish a firm time-period for receipt of the responding party's submission. Any subsequent written submissions shall be submitted simultaneously.
7. Where the parties to the dispute have failed to develop a mutually satisfactory solution, the panel shall submit its findings in the form of a written report to the DSB. In such cases, the report of a panel shall set out the findings of fact, the applicability of relevant provisions and the basic rationale behind any findings and recommendations that it makes. Where a settlement of the matter among the parties to the dispute has been found, the report of the panel shall be confined to a brief description of the case and to reporting that a solution has been reached.
8. In order to make the procedures more efficient, the period in which the panel shall conduct its examination, from the date that the composition and terms of reference of the panel have been agreed upon until the date the final report is issued to the parties to the dispute, shall, as a general rule, not exceed six months. In cases of urgency, including those relating to perishable goods, the panel shall aim to issue its report to the parties to the dispute within three months.
9. When the panel considers that it cannot issue its report within six months, or within three months in cases of urgency, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will issue its report. In no case should the period from the establishment of the panel to the circulation of the report to the Members exceed nine months.
10. In the context of consultations involving a measure taken by a developing country Member, the parties may agree to extend the periods established in paragraphs 7 and 8 of

Article 4. If, after the relevant period has elapsed, the consulting parties cannot agree that the consultations have concluded, the Chairman of the DSB shall decide, after consultation with the parties, whether to extend the relevant period and, if so, for how long. In addition, in examining a complaint against a developing country Member, the panel shall accord sufficient time for the developing country Member to prepare and present its argumentation. The provisions of paragraph 1 of Article 20 and paragraph 4 of Article 21 are not affected by any action pursuant to this paragraph.

11. Where one or more of the parties is a developing country Member, the panel's report shall explicitly indicate the form in which account has been taken of relevant provisions on differential and more-favourable treatment for developing country Members that form part of the covered agreements which have been raised by the developing country Member in the course of the dispute settlement procedures.

12. The panel may suspend its work at any time at the request of the complaining party for a period not to exceed 12 months. In the event of such a suspension, the time-frames set out in paragraphs 8 and 9 of this Article, paragraph 1 of Article 20, and paragraph 4 of Article 21 shall be extended by the amount of time that the work was suspended. If the work of the panel has been suspended for more than 12 months, the authority for establishment of the panel shall lapse.

### Article 13: Right to Seek Information

1. Each panel shall have the right to seek information and technical advice from any individual or body which it deems appropriate. However, before a panel seeks such information or advice from any individual or body within the jurisdiction of a Member it shall inform the authorities of that Member. A Member should respond promptly and fully to any request by a panel for such information as the panel considers necessary and appropriate. Confidential information which is provided shall not be revealed without formal authorization from the individual, body, or authorities of the Member providing the information.

2. Panels may seek information from any relevant source and may consult experts to obtain their opinion on certain aspects of the matter. With respect to a factual issue concerning a scientific or other technical matter raised by a party to a dispute, a panel may request an advisory report in writing from an expert review group. Rules for the establishment of such a group and its procedures are set forth in Appendix 4.

### Article 14: Confidentiality

1. Panel deliberations shall be confidential.
2. The reports of panels shall be drafted without the presence of the parties to the dispute in the light of the information provided and the statements made.
3. Opinions expressed in the panel report by individual panelists shall be anonymous.

### Article 15: Interim Review Stage

1. Following the consideration of rebuttal submissions and oral arguments, the panel shall issue the descriptive (factual and argument) sections of its draft report to the parties to the dispute. Within a period of time set by the panel, the parties shall submit their comments in writing.

2. Following the expiration of the set period of time for receipt of comments from the parties to the dispute, the panel shall issue an interim report to the parties, including both the descriptive sections and the panel's findings and conclusions. Within a period of time set by the panel, a party may submit a written request for the panel to review precise aspects of the interim report prior to circulation of the final report to the Members. At the request of a party, the panel shall hold a further meeting with the parties on the issues identified in the written comments. If no comments are received from any party within the comment period, the interim report shall be considered the final panel report and circulated promptly to the Members.

3. The findings of the final panel report shall include a discussion of the arguments made at the interim review stage. The interim review stage shall be conducted within the time-period set out in paragraph 8 of Article 12.

### Article 16: Adoption of Panel Reports

1. In order to provide sufficient time for the Members to consider panel reports, the reports shall not be considered for adoption by the DSB until 20 days after the date they have been circulated to the Members.

2. Members having objections to a panel report shall give written reasons to explain their objections for circulation at least 10 days prior to the DSB meeting at which the panel report will be considered.

3. The parties to a dispute shall have the right to participate fully in the consideration of the panel report by the DSB, and their views shall be fully recorded.

4. Within 60 days after the date of circulation of a panel report to the Members, the report shall be adopted at a DSB meeting<sup>7</sup> unless a party to the dispute formally notifies the DSB of its decision to appeal or the DSB decides by consensus not to adopt the report. If a party has notified its decision to appeal, the report by the panel shall not be considered for adoption by the DSB until after completion of the appeal. This adoption procedure is without prejudice to the right of Members to express their views on a panel report.

<sup>7</sup>If a meeting of the DSB is not scheduled within this period at a time that enables the requirements of paragraphs 1 and 4 of Article 16 to be met, a meeting of the DSB shall be held for this purpose.

### Article 17: Appellate Review

#### *Standing Appellate Body*

1. A standing Appellate Body shall be established by the DSB. The Appellate Body shall hear appeals from panel cases. It shall be composed of seven persons, three of whom shall serve on any one case. Persons serving on the Appellate Body shall serve in rotation. Such rotation shall be determined in the working procedures of the Appellate Body.
2. The DSB shall appoint persons to serve on the Appellate Body for a four-year term, and each person may be reappointed once. However, the terms of three of the seven persons appointed immediately after the entry into force of the WTO Agreement shall expire at the end of two years, to be determined by lot. Vacancies shall be filled as they arise. A person appointed to replace a person whose term of office has not expired shall hold office for the remainder of the predecessor's term.
3. The Appellate Body shall comprise persons of recognized authority, with demonstrated expertise in law, international trade and the subject matter of the covered agreements generally. They shall be unaffiliated with any government. The Appellate Body membership shall be broadly representative of membership in the WTO. All persons serving on the Appellate Body shall be available at all times and on short notice, and shall stay abreast of dispute settlement activities and other relevant activities of the WTO. They shall not participate in the consideration of any disputes that would create a direct or indirect conflict of interest.

4. Only parties to the dispute, not third parties, may appeal a panel report. Third parties which have notified the DSB of a substantial interest in the matter pursuant to paragraph 2 of Article 10 may make written submissions to, and be given an opportunity to be heard by, the Appellate Body.

5. As a general rule, the proceedings shall not exceed 60 days from the date a party to the dispute formally notifies its decision to appeal to the date the Appellate Body circulates its report. In fixing its timetable the Appellate Body shall take into account the provisions of paragraph 9 of Article 4, if relevant. When the Appellate Body considers that it cannot provide its report within 60 days, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will submit its report. In no case shall the proceedings exceed 90 days.

6. An appeal shall be limited to issues of law covered in the panel report and legal interpretations developed by the panel.

7. The Appellate Body shall be provided with appropriate administrative and legal support as it requires.

8. The expenses of persons serving on the Appellate Body, including travel and subsistence allowance, shall be met from the WTO budget in accordance with criteria to be adopted by the General Council, based on recommendations of the Committee on Budget, Finance and Administration.

#### *Procedures for Appellate Review*

9. Working procedures shall be drawn up by the Appellate Body in consultation with the Chairman of the DSB and the Director-General, and communicated to the Members for their information.

10. The proceedings of the Appellate Body shall be confidential. The reports of the Appellate Body shall be drafted without the presence of the parties to the dispute and in the light of the information provided and the statements made.

11. Opinions expressed in the Appellate Body report by individuals serving on the Appellate Body shall be anonymous.

12. The Appellate Body shall address each of the issues raised in accordance with paragraph 6 during the appellate proceeding.

13. The Appellate Body may uphold, modify or reverse the legal findings and conclusions of the panel.

#### *Adoption of Appellate Body Reports*

14. An Appellate Body report shall be adopted by the DSB and unconditionally accepted by the parties to the dispute unless the DSB decides by consensus not to adopt the Appellate Body report within 30 days following its circulation to the Members.<sup>8</sup> This adoption procedure is without prejudice to the right of Members to express their views on an Appellate Body report.

### Article 18: Communications with the Panel or Appellate Body

1. There shall be no *ex parte* communications with the panel or Appellate Body concerning matters under consideration by the panel or Appellate Body.

2. Written submissions to the panel or the Appellate Body shall be treated as confidential, but shall be made available to the parties to the dispute. Nothing in this Understanding shall preclude a party to a dispute from disclosing statements of its own positions to the public. Members shall treat as confidential information submitted by another Member to the panel or the Appellate Body which that Member has designated as confidential. A party to a dispute shall also, upon request of a Member, provide a non-confidential summary of the information contained in its written submissions that could be disclosed to the public.

### Article 19: Panel and Appellate Body Recommendations

1. Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned<sup>9</sup> bring the measure into conformity with that agreement.<sup>10</sup> In addition to its recommendations, the panel or Appellate Body may suggest ways in which the Member concerned could implement the recommendations.

<sup>8</sup>If a meeting of the DSB is not scheduled during this period, such a meeting of the DSB shall be held for this purpose.

<sup>9</sup>The "Member concerned" is the party to the dispute to which the panel or Appellate Body recommendations are directed.

<sup>10</sup>With respect to recommendations in cases not involving a violation of GATT 1994 or any other covered agreement, see Article 26.

4. Except where the panel or the Appellate Body has extended, pursuant to paragraph 9 of Article 12 or paragraph 5 of Article 17, the time of providing its report, the period from the date of establishment of the panel by the DSB until the date of determination of the reasonable period of time shall not exceed 15 months unless the parties to the dispute agree otherwise. Where either the panel or the Appellate Body has acted to extend the time of providing its report, the additional time taken shall be added to the 15-month period; provided that unless the parties to the dispute agree that there are exceptional circumstances, the total time shall not exceed 18 months.

5. Where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures, including wherever possible resort to the original panel. The panel shall circulate its report within 90 days after the date of referral of the matter to it. When the panel considers that it cannot provide its report within this time frame, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will submit its report.

6. The DSB shall keep under surveillance the implementation of adopted recommendations or rulings. The issue of implementation of the recommendations or rulings may be raised at the DSB by any Member at any time following their adoption. Unless the DSB decides otherwise, the issue of implementation of the recommendations or rulings shall be placed on the agenda of the DSB meeting after six months following the date of establishment of the reasonable period of time pursuant to paragraph 3 and shall remain on the DSB's agenda until the issue is resolved. At least 10 days prior to each such DSB meeting, the Member concerned shall provide the DSB with a status report in writing of its progress in the implementation of the recommendations or rulings.

7. If the matter is one which has been raised by a developing country Member, the DSB shall consider what further action it might take which would be appropriate to the circumstances.

8. If the case is one brought by a developing country Member, in considering what appropriate action might be taken, the DSB shall take into account not only the trade coverage of measures complained of, but also their impact on the economy of developing country Members concerned.

## Article 22: Compensation and the Suspension of Concessions

1. Compensation and the suspension of concessions or other obligations are temporary measures available in the event that the recommendations and rulings are not implemented within a reasonable period of time. However, neither compensation nor the suspension of concessions or other obligations is preferred to full implementation of a recommendation to bring a measure into conformity with the covered agreements. Compensation is voluntary and, if granted, shall be consistent with the covered agreements.

2. If the Member concerned fails to bring the measure found to be inconsistent with a covered agreement into compliance therewith or otherwise comply with the recommendations and rulings within the reasonable period of time determined pursuant to paragraph 3 of Article 21, such Member shall, if so requested, and no later than the expiry of the reasonable period of time, enter into negotiations with any party having invoked the dispute settlement procedures,

2. In accordance with paragraph 2 of Article 3, in their findings and recommendations, the panel and Appellate Body cannot add to or diminish the rights and obligations provided in the covered agreements.

## Article 20: Time-frame for DSB Decisions

Unless otherwise agreed to by the parties to the dispute, the period from the date of establishment of the panel by the DSB until the date the DSB considers the panel or appellate report for adoption shall as a general rule not exceed nine months where the panel report is not appealed or 12 months where the report is appealed. Where either the panel or the Appellate Body has acted, pursuant to paragraph 9 of Article 12 or paragraph 5 of Article 17, to extend the time for providing its report, the additional time taken shall be added to the above periods.

## Article 21: Surveillance of Implementation of Recommendations and Rulings

1. Prompt compliance with recommendations or rulings of the DSB is essential in order to ensure effective resolution of disputes to the benefit of all Members.

2. Particular attention should be paid to matters affecting the interests of developing country Members with respect to measures which have been subject to dispute settlement.

3. At a DSB meeting held within 30 days<sup>11</sup> after the date of adoption of the panel or Appellate Body report, the Member concerned shall inform the DSB of its intentions in respect of implementation of the recommendations and rulings of the DSB. If it is impracticable to comply immediately with the recommendations and rulings, the Member concerned shall have a reasonable period of time in which to do so. The reasonable period of time shall be:

- (a) the period of time proposed by the Member concerned, provided that such period is approved by the DSB; or, in the absence of such approval,
- (b) a period of time mutually agreed by the parties to the dispute within 45 days after the date of adoption of the recommendations and rulings; or, in the absence of such agreement,
- (c) a period of time determined through binding arbitration within 90 days after the date of adoption of the recommendations and rulings.<sup>12</sup> In such arbitration, a guideline for the arbitrator<sup>13</sup> should be that the reasonable period of time to implement panel or Appellate Body recommendations should not exceed 15 months from the date of adoption of a panel or Appellate Body report. However, that time may be shorter or longer, depending upon the particular circumstances.

<sup>11</sup>If a meeting of the DSB is not scheduled during this period, such a meeting of the DSB shall be held for this purpose.

<sup>12</sup>If the parties cannot agree on an arbitrator within ten days after referring the matter to arbitration, the arbitrator shall be appointed by the Director-General within ten days, after consulting the parties.

<sup>13</sup>The expression "arbitrator" shall be interpreted as referring either to an individual or a group.

with a view to developing mutually acceptable compensation. If no satisfactory compensation has been agreed within 20 days after the date of expiry of the reasonable period of time, any party having invoked the dispute settlement procedures may request authorization from the DSB to suspend the application to the Member concerned of concessions or other obligations under the covered agreements.

3. In considering what concessions or other obligations to suspend, the complaining party shall apply the following principles and procedures:
  - (a) the general principle is that the complaining party should first seek to suspend concessions or other obligations with respect to the same sector(s) as that in which the panel or Appellate Body has found a violation or other nullification or impairment;
  - (b) if that party considers that it is not practicable or effective to suspend concessions or other obligations with respect to the same sector(s), it may seek to suspend concessions or other obligations in other sectors under the same agreement;
  - (c) if that party considers that it is not practicable or effective to suspend concessions or other obligations with respect to other sectors under the same agreement, and that the circumstances are serious enough, it may seek to suspend concessions or other obligations under another covered agreement;
  - (d) in applying the above principles, that party shall take into account:
    - (i) the trade in the sector or under the agreement under which the panel or Appellate Body has found a violation or other nullification or impairment, and the importance of such trade to that party;
    - (ii) the broader economic elements related to the nullification or impairment and the broader economic consequences of the suspension of concessions or other obligations;
    - (e) if that party decides to request authorization to suspend concessions or other obligations pursuant to subparagraphs (b) or (c), it shall state the reasons therefor in its request. At the same time as the request is forwarded to the DSB, it also shall be forwarded to the relevant Councils and also, in the case of a request pursuant to subparagraph (b), the relevant sectoral bodies;
    - (f) for purposes of this paragraph, "sector" means:
      - (i) with respect to goods, all goods;
      - (ii) with respect to services, a principal sector as identified in the current "Services Sectoral Classification List" which identifies such sectors;<sup>14</sup>
      - (iii) with respect to trade-related intellectual property rights, each of the categories of intellectual property rights covered in Section 1, or

<sup>14</sup>The list in document MTN.GNS/W/120 identifies eleven sectors.

Section 2, or Section 3, or Section 4, or Section 5, or Section 6, or Section 7 of Part II, or the obligations under Part III, or Part IV of the Agreement on TRIPS;

- (g) for purposes of this paragraph, "agreement" means:
  - (i) with respect to goods, the agreements listed in Annex 1A of the WTO Agreement, taken as a whole as well as the Plurilateral Trade Agreements in so far as the relevant parties to the dispute are parties to these agreements;
  - (ii) with respect to services, the GATS;
  - (iii) with respect to intellectual property rights, the Agreement on TRIPS.
4. The level of the suspension of concessions or other obligations authorized by the DSB shall be equivalent to the level of the nullification or impairment.
5. The DSB shall not authorize suspension of concessions or other obligations if a covered agreement prohibits such suspension.
6. When the situation described in paragraph 2 occurs, the DSB, upon request, shall grant authorization to suspend concessions or other obligations within 30 days of the expiry of the reasonable period of time unless the DSB decides by consensus to reject the request. However, if the Member concerned objects to the level of suspension proposed, or claims that the principles and procedures set forth in paragraph 3 have not been followed where a complaining party has requested authorization to suspend concessions or other obligations pursuant to paragraph 3(b) or (c), the matter shall be referred to arbitration. Such arbitration shall be carried out by the original panel, if members are available, or by an arbitrator<sup>15</sup> appointed by the Director-General and shall be completed within 60 days after the date of expiry of the reasonable period of time. Concessions or other obligations shall not be suspended during the course of the arbitration.
7. The arbitrator<sup>16</sup> acting pursuant to paragraph 6 shall not examine the nature of the concessions or other obligations to be suspended but shall determine whether the level of such suspension is equivalent to the level of nullification or impairment. The arbitrator may also determine if the proposed suspension of concessions or other obligations is allowed under the covered agreement. However, if the matter referred to arbitration includes a claim that the principles and procedures set forth in paragraph 3 have not been followed, the arbitrator shall examine that claim. In the event the arbitrator determines that those principles and procedures have not been followed, the complaining party shall apply them consistent with paragraph 3. The parties shall accept the arbitrator's decision as final and the parties concerned shall not seek a second arbitration. The DSB shall be informed promptly of the decision of the arbitrator and shall upon request, grant authorization to suspend concessions or other obligations where the request is consistent with the decision of the arbitrator, unless the DSB decides by consensus to reject the request.

<sup>15</sup>The expression "arbitrator" shall be interpreted as referring either to an individual or a group.

<sup>16</sup>The expression "arbitrator" shall be interpreted as referring either to an individual or a group or to the members of the original panel when serving in the capacity of arbitrator.

### Article 24: Special Procedures Involving Least-Developed Country Members

1. At all stages of the determination of the causes of a dispute and of dispute settlement procedures involving a least-developed country Member, particular consideration shall be given to the special situation of least-developed country Members. In this regard, Members shall exercise due restraint in raising matters under these procedures involving a least-developed country Member. If nullification or impairment is found to result from a measure taken by a least-developed country Member, complaining parties shall exercise due restraint in asking for compensation or seeking authorization to suspend the application of concessions or other obligations pursuant to these procedures.
2. In dispute settlement cases involving a least-developed country Member, where a satisfactory solution has not been found in the course of consultations the Director-General or the Chairman of the DSB shall, upon request by a least-developed country Member offer their good offices, conciliation and mediation with a view to assisting the parties to settle the dispute, before a request for a panel is made. The Director-General or the Chairman of the DSB, in providing the above assistance, may consult any source which either deems appropriate.

### Article 25: Arbitration

1. Expeditious arbitration within the WTO as an alternative means of dispute settlement can facilitate the solution of certain disputes that concern issues that are clearly defined by both parties.
2. Except as otherwise provided in this Understanding, resort to arbitration shall be subject to mutual agreement of the parties which shall agree on the procedures to be followed. Agreements to resort to arbitration shall be notified to all Members sufficiently in advance of the actual commencement of the arbitration process.
3. Other Members may become party to an arbitration proceeding only upon the agreement of the parties which have agreed to have recourse to arbitration. The parties to the proceeding shall agree to abide by the arbitration award. Arbitration awards shall be notified to the DSB and the Council or Committee of any relevant agreement where any Member may raise any point relating thereto.
4. Articles 21 and 22 of this Understanding shall apply *mutatis mutandis* to arbitration awards.

### Article 26

1. Non-Violation Complaints of the Type Described in Paragraph 1(b) of Article XXIII of GATT 1994

Where the provisions of paragraph 1(b) of Article XXIII of GATT 1994 are applicable to a covered agreement, a panel or the Appellate Body may only make rulings and

8. The suspension of concessions or other obligations shall be temporary and shall only be applied until such time as the measure found to be inconsistent with a covered agreement has been removed, or the Member that must implement recommendations or rulings provides a solution to the nullification or impairment of benefits, or a mutually satisfactory solution is reached. In accordance with paragraph 6 of Article 21, the DSB shall continue to keep under surveillance the implementation of adopted recommendations or rulings, including those cases where compensation has been provided or concessions or other obligations have been suspended but the recommendations to bring a measure into conformity with the covered agreements have not been implemented.

9. The dispute settlement provisions of the covered agreements may be invoked in respect of measures affecting their observance taken by regional or local governments or authorities within the territory of a Member. When the DSB has ruled that a provision of a covered agreement has not been observed, the responsible Member shall take such reasonable measures as may be available to it to ensure its observance. The provisions of the covered agreements and this Understanding relating to compensation and suspension of concessions or other obligations apply in cases where it has not been possible to secure such observance.<sup>17</sup>

### Article 23: Strengthening of the Multilateral System

1. When Members seek the redress of a violation of obligations or other nullification or impairment of benefits under the covered agreements or an impediment to the attainment of any objective of the covered agreements, they shall have recourse to, and abide by, the rules and procedures of this Understanding.
2. In such cases, Members shall:
  - (a) not make a determination to the effect that a violation has occurred, that benefits have been nullified or impaired or that the attainment of any objective of the covered agreements has been impeded, except through recourse to dispute settlement in accordance with the rules and procedures of this Understanding, and shall make any such determination consistent with the findings contained in the panel or Appellate Body report adopted by the DSB or an arbitration award rendered under this Understanding;
  - (b) follow the procedures set forth in Article 21 to determine the reasonable period of time for the Member concerned to implement the recommendations and rulings; and
  - (c) follow the procedures set forth in Article 22 to determine the level of suspension of concessions or other obligations and obtain DSB authorization in accordance with those procedures before suspending concessions or other obligations under the covered agreements in response to the failure of the Member concerned to implement the recommendations and rulings within that reasonable period of time.

<sup>17</sup>Where the provisions of any covered agreement concerning measures taken by regional or local governments or authorities within the territory of a Member contain provisions different from the provisions of this paragraph, the provisions of such covered agreement shall prevail.

recommendations where a party to the dispute considers that any benefit accruing to it directly or indirectly under the relevant covered agreement is being nullified or impaired or the attainment of any objective of that Agreement is being impeded as a result of the application by a Member of any measure, whether or not it conflicts with the provisions of that Agreement. Where and to the extent that such party considers and a panel or the Appellate Body determines that a case concerns a measure that does not conflict with the provisions of a covered agreement to which the provisions of paragraph 1(b) of Article XXIII of GATT 1994 are applicable, the procedures in this Understanding shall apply, subject to the following:

- (a) the complaining party shall present a detailed justification in support of any complaint relating to a measure which does not conflict with the relevant covered agreement;
- (b) where a measure has been found to nullify or impair benefits under, or impede the attainment of objectives, of the relevant covered agreement without violation thereof, there is no obligation to withdraw the measure. However, in such cases, the panel or the Appellate Body shall recommend that the Member concerned make a mutually satisfactory adjustment;
- (c) notwithstanding the provisions of Article 21, the arbitration provided for in paragraph 3 of Article 21, upon request of either party, may include a determination of the level of benefits which have been nullified or impaired, and may also suggest ways and means of reaching a mutually satisfactory adjustment; such suggestions shall not be binding upon the parties to the dispute;
- (d) notwithstanding the provisions of paragraph 1 of Article 22, compensation may be part of a mutually satisfactory adjustment as final settlement of the dispute.

## 2. Complaints of the Type Described in Paragraph 1(c) of Article XXIII of GATT 1994

Where the provisions of paragraph 1(c) of Article XXIII of GATT 1994 are applicable to a covered agreement, a panel may only make rulings and recommendations where a party considers that any benefit accruing to it directly or indirectly under the relevant covered agreement is being nullified or impaired or the attainment of any objective of that Agreement is being impeded as a result of the existence of any situation other than those to which the provisions of paragraphs 1(a) and 1(b) of Article XXIII of GATT 1994 are applicable. Where and to the extent that such party considers and a panel determines that the matter is covered by this paragraph, the procedures of this Understanding shall apply only up to and including the point in the proceedings where the panel report has been circulated to the Members. The dispute settlement rules and procedures contained in the Decision of 12 April 1989 (BISD 36S/61-67) shall apply to consideration for adoption, and surveillance and implementation of recommendations and rulings. The following shall also apply:

- (a) the complaining party shall present a detailed justification in support of any argument made with respect to issues covered under this paragraph;
- (b) in cases involving matters covered by this paragraph, if a panel finds that cases also involve dispute settlement matters other than those covered by this

paragraph, the panel shall circulate a report to the DSB addressing any such matters and a separate report on matters falling under this paragraph.

## Article 27: Responsibilities of the Secretariat

1. The Secretariat shall have the responsibility of assisting panels, especially on the legal, historical and procedural aspects of the matters dealt with, and of providing secretarial and technical support.
2. While the Secretariat assists Members in respect of dispute settlement at their request, there may also be a need to provide additional legal advice and assistance in respect of dispute settlement to developing country Members. To this end, the Secretariat shall make available a qualified legal expert from the WTO technical cooperation services to any developing country Member which so requests. This expert shall assist the developing country Member in a manner ensuring the continued impartiality of the Secretariat.
3. The Secretariat shall conduct special training courses for interested Members concerning these dispute settlement procedures and practices so as to enable Members' experts to be better informed in this regard.

## APPENDIX 1: AGREEMENTS COVERED BY THE UNDERSTANDING

- (A) Agreement Establishing the World Trade Organization
- (B) Multilateral Trade Agreements
  - Annex 1A: Multilateral Agreements on Trade in Goods
  - Annex 1B: General Agreement on Trade in Services
  - Annex 1C: Agreement on Trade-Related Aspects of Intellectual Property Rights
  - Annex 2: Understanding on Rules and Procedures Governing the Settlement of Disputes
- (C) Plurilateral Trade Agreements
  - Annex 4: Agreement on Trade in Civil Aircraft
  - Agreement on Government Procurement
  - International Dairy Agreement
  - International Bovine Meat Agreement

The applicability of this Understanding to the Plurilateral Trade Agreements shall be subject to the adoption of a decision by the parties to each agreement setting out the terms for the application of the Understanding to the individual agreement, including any special or additional rules or procedures for inclusion in Appendix 2, as notified to the DSB.

## APPENDIX 2: SPECIAL OR ADDITIONAL RULES AND PROCEDURES CONTAINED IN THE COVERED AGREEMENTS

<i>Agreement</i>	<i>Rules and Procedures</i>
Agreement on the Application of Sanitary and Phytosanitary Measures	11.2
Agreement on Textiles and Clothing	2.14, 2.21, 4.4, 5.2, 5.4, 5.6, 6.9, 6.10, 6.11, 8.1 through 8.12
Agreement on Technical Barriers to Trade	14.2 through 14.4, Annex 2
Agreement on Implementation of Article VI of GATT 1994	17.4 through 17.7
Agreement on Implementation of Article VII of GATT 1994	19.3 through 19.5, Annex II.2(f), 3, 9, 21
Agreement on Subsidies and Countervailing Measures	4.2 through 4.12, 6.6, 7.2 through 7.10, 8.5, footnote 35, 24.4, 27.7, Annex V
General Agreement on Trade in Services	XXII:3, XXIII:3
Annex on Financial Services	4
Annex on Air Transport Services	4
Decision on Certain Dispute Settlement Procedures for the GATS	1 through 5

The list of rules and procedures in this Appendix includes provisions where only a part of the provision may be relevant in this context.

Any special or additional rules or procedures in the Plurilateral Trade Agreements as determined by the competent bodies of each agreement and as notified to the DSB.

### APPENDIX 3: WORKING PROCEDURES

1. In its proceedings the panel shall follow the relevant provisions of this Understanding. In addition, the following working procedures shall apply.
2. The panel shall meet in closed session. The parties to the dispute, and interested parties, shall be present at the meetings only when invited by the panel to appear before it.
3. The deliberations of the panel and the documents submitted to it shall be kept confidential. Nothing in this Understanding shall preclude a party to a dispute from disclosing statements of its own positions to the public. Members shall treat as confidential information submitted by another Member to the panel which that Member has designated as confidential. Where a party to a dispute submits a confidential version of its written submissions to the panel, it shall also, upon request of a Member, provide a non-confidential summary of the information contained in its submissions that could be disclosed to the public.
4. Before the first substantive meeting of the panel with the parties, the parties to the dispute shall transmit to the panel written submissions in which they present the facts of the case and their arguments.
5. At its first substantive meeting with the parties, the panel shall ask the party which has brought the complaint to present its case. Subsequently, and still at the same meeting, the party against which the complaint has been brought shall be asked to present its point of view.
6. All third parties which have notified their interest in the dispute to the DSB shall be invited in writing to present their views during a session of the first substantive meeting of the panel set aside for that purpose. All such third parties may be present during the entirety of this session.
7. Formal rebuttals shall be made at a second substantive meeting of the panel. The party complained against shall have the right to take the floor first to be followed by the complaining party. The parties shall submit, prior to that meeting, written rebuttals to the panel.
8. The panel may at any time put questions to the parties and ask them for explanations either in the course of a meeting with the parties or in writing.
9. The parties to the dispute and any third party invited to present its views in accordance with Article 10 shall make available to the panel a written version of their oral statements.
10. In the interest of full transparency, the presentations, rebuttals and statements referred to in paragraphs 5 to 9 shall be made in the presence of the parties. Moreover, each party's written submissions, including any comments on the descriptive part of the report and responses to questions put by the panel, shall be made available to the other party or parties.
11. Any additional procedures specific to the panel.

#### 12. Proposed timetable for panel work:

- |     |  |           |
|-----|--|-----------|
| (a) | Receipt of first written submissions of the parties:                                     |           |
|     | (1) complaining Party:   | 3-6 weeks |
|     | (2) Party complained against:  | 2-3 weeks |
| (b) | Date, time and place of first substantive meeting with the parties; third party session: | 1-2 weeks |
| (c) | Receipt of written rebuttals of the parties:   | 2-3 weeks |
| (d) | Date, time and place of second substantive meeting with the parties:                     | 1-2 weeks |
| (e) | Issuance of descriptive part of the report to the parties:                               | 2-4 weeks |
| (f) | Receipt of comments by the parties on the descriptive part of the report:                | 2 weeks   |
| (g) | Issuance of the interim report, including the findings and conclusions, to the parties:  | 2-4 weeks |
| (h) | Deadline for party to request review of part(s) of report:                               | 1 week    |
| (i) | Period of review by panel, including possible additional meeting with parties:           | 2 weeks   |
| (j) | Issuance of final report to parties to dispute:  | 2 weeks   |
| (k) | Circulation of the final report to the Members:  | 3 weeks   |

The above calendar may be changed in the light of unforeseen developments. Additional meetings with the parties shall be scheduled if required.

#### **APPENDIX 4: EXPERT REVIEW GROUPS**

The following rules and procedures shall apply to expert review groups established in accordance with the provisions of paragraph 2 of Article 13.

1. Expert review groups are under the panel's authority. Their terms of reference and detailed working procedures shall be decided by the panel, and they shall report to the panel.
2. Participation in expert review groups shall be restricted to persons of professional standing and experience in the field in question.
3. Citizens of parties to the dispute shall not serve on an expert review group without the joint agreement of the parties to the dispute, except in exceptional circumstances when the panel considers that the need for specialized scientific expertise cannot be fulfilled otherwise. Government officials of parties to the dispute shall not serve on an expert review group. Members of expert review groups shall serve in their individual capacities and not as government representatives, nor as representatives of any organization. Governments or organizations shall therefore not give them instructions with regard to matters before an expert review group.
4. Expert review groups may consult and seek information and technical advice from any source they deem appropriate. Before an expert review group seeks such information or advice from a source within the jurisdiction of a Member, it shall inform the government of that Member. Any Member shall respond promptly and fully to any request by an expert review group for such information as the expert review group considers necessary and appropriate.
5. The parties to a dispute shall have access to all relevant information provided to an expert review group, unless it is of a confidential nature. Confidential information provided to the expert review group shall not be released without formal authorization from the government, organization or person providing the information. Where such information is requested from the expert review group but release of such information by the expert review group is not authorized, a non-confidential summary of the information will be provided by the government, organization or person supplying the information.
6. The expert review group shall submit a draft report to the parties to the dispute with a view to obtaining their comments, and taking them into account, as appropriate, in the final report, which shall also be issued to the parties to the dispute when it is submitted to the panel. The final report of the expert review group shall be advisory only.



**World Trade Organization**

**United States – Standards for Reformulated and  
Conventional Gasoline**

**Report of the Appellate Body, 29 April 1996**

**Appellate Body**

***United States - Standards for Reformulated and  
Conventional Gasoline***

**AB-1996-1**

United States, Appellant  
Brazil  
Venezuela, Appellees  
European Communities  
Norway, Third Participants

Present:

Feliciano, Presiding Member  
Beeby, Member  
Matsushita, Member

**United States - Standards for Reformulated  
and Conventional Gasoline**

**AB-1996-1**

**I. Introductory**

The United States appeals from certain conclusions on issues of law and certain legal interpretations contained in the Panel Report, *United States - Standards for Reformulated and Conventional Gasoline*, WT/DS2/R, 29 January 1996 (the "Panel Report"). That Panel had been established to consider a dispute between the United States, on the one hand, and Venezuela, later joined by Brazil, on the other. The dispute related to the implementation by the United States of its domestic legislation known as the Clean Air Act of 1990 (the "CAA") and, more specifically, to the regulation enacted by the United States' Environmental Protection Agency (the "EPA") pursuant to that Act, to control toxic and other pollution caused by the combustion of gasoline manufactured in or imported into the United States. This regulation is formally entitled "*Regulation of Fuels and Fuel Additives - Standards for Reformulated and Conventional Gasoline*", Part 80 of Title 40 of the Code of Federal Regulations,<sup>1</sup> and is commonly referred to as the Gasoline Rule.

**Report of the Appellate Body**

A. Procedural Matters

<sup>1</sup>40 CFR 80, 59 Fed. Reg. 7716 (16 February 1994).

On 21 February 1996, the United States notified the Dispute Settlement Body of its decision to appeal certain conclusions on issues of law and legal interpretations in the Panel Report pursuant to Article 16 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU")<sup>2</sup> and simultaneously filed a Notice of Appeal with the Appellate Body, pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "*Working Procedures*").<sup>3</sup> Thereafter, on 4 March 1996, the United States filed its Submission as Appellant.<sup>4</sup> Venezuela in turn filed, on 18 March 1996, its Appellee's Submission; Brazil filed on the same day its Appellee's Submission.<sup>5</sup> The third participants followed, the European Communities and Norway filing Submissions, on 18 March 1996.<sup>6</sup>

The complete record of the Panel proceedings was duly transmitted to the Appellate Body.<sup>7</sup>

The oral hearing contemplated by Rule 27 of the *Working Procedures* was held on 27 and 28 March 1996.<sup>8</sup> At the hearing, oral arguments were made respectively by the participants and the third participants. Questions were put to them by the Members of the Appellate Body hearing the appeal. Most of these questions were answered orally, and some were responded to in writing with the responses being furnished both to the Appellate Body and the other participants and third participants.<sup>9</sup> In addition, the participants and third participants were invited to provide, and did provide, the Appellate Body and each other with final written statements of their respective positions.<sup>10</sup> All the participants and third participants responded positively and punctually, which was a source of satisfaction for the Appellate Body.

<sup>2</sup>WT/DS2/6.

<sup>3</sup>WT/AB/WP/1, 15 February 1996.

<sup>4</sup>Pursuant to Rule 21(1) of the *Working Procedures*.

<sup>5</sup>Pursuant to Rule 22(1) of the *Working Procedures*.

<sup>6</sup>Pursuant to Rule 24 of the *Working Procedures*.

<sup>7</sup>Pursuant to Rule 25 of the *Working Procedures*.

<sup>8</sup>The oral hearing was originally scheduled for 25 March 1996 but had, for exceptional and unavoidable reasons, to be deferred to 27 and 28 March 1996.

<sup>9</sup>Rule 28 of the *Working Procedures*.

<sup>10</sup>Rule 28(1) of the *Working Procedures*.

B. The Clean Air Act and its Implementation

The CAA and its implementation by the Gasoline Rule, are described fully at paragraphs 2.1-2.13 of the Panel Report. However, it may be convenient to recall a number of the Panel's factual findings at this stage.

The CAA established two gasoline programs<sup>11</sup> to ensure that pollution from gasoline combustion does not exceed 1990 levels and that pollutants in major population centres are reduced. The first program concerns ozone "nonattainment areas", consisting of (i) nine large metropolitan areas that have experienced the worst summertime ozone pollution and (ii) various additional areas included at the request of the state governors concerned. All gasoline sold to consumers in these nonattainment areas must be "reformulated." The sale of conventional gasoline in nonattainment areas is prohibited. The second program concerns "conventional" gasoline, which may be sold to consumers in the rest of the United States. The implementation of both programs, which apply to gasoline sold by domestic refiners, blenders and importers, was entrusted to the EPA. As a result, the EPA adopted the Gasoline Rule, which relies heavily on the use of 1990 baselines as a means of determining compliance with the CAA requirements.

1. The Reformulated Gasoline Program

The CAA established certain compositional and performance specifications for reformulated gasoline.<sup>12</sup> Thus, the oxygen content must not be less than 2.0 per cent by weight, the benzene content must not exceed 1.0 per cent by volume and the gasoline must be free of heavy metals, including lead or manganese. The performance specifications of the CAA require a 15 per cent reduction in the emissions of both volatile organic compounds ("VOCs") and toxic air pollutants ("toxics"), and no increase in emissions of nitrogen oxides ("NOx"). Section 80.41 of the Gasoline Rule sets out two methods by which entities can certify their gasoline as meeting these requirements. From 1 January 1995 to 1 January 1998, domestic refiners, blenders and importers may use an interim method of certification called the "Simple Model", which requires compliance with fixed specifications concerning Reid Vapour Pressure, oxygen, benzene and toxics performance. In addition, compliance is required with certain "non-degradation requirements" by maintaining sulphur, olefins and T-90 qualities at or below 1990 baseline levels, on an average annual basis. As of 1 January 1998, these entities must comply with the "Complex Model", which more accurately predicts emissions performance. The Complex Model is not in issue in the present dispute.

2. The Conventional Gasoline Program

<sup>11</sup>Section 211(k).

<sup>12</sup>Section 211(k)(2)-(3).

In order to prevent the "dumping" of pollutants extracted from reformulated gasoline into conventional gasoline, the CAA requires that conventional gasoline sold by domestic refiners, blenders and importers in the United States remains as clean as 1990 baseline levels.<sup>13</sup> Unlike the Simple Model for reformulated gasoline, the "non-degradation" from 1990 baseline requirements for conventional gasoline applies in respect of all conventional gasoline qualities, and not only sulphur, olefins and T-90. Compliance is measured by comparing emissions from the conventional gasoline sold by domestic refiners, blenders and importers against emissions from a 1990 baseline and is assessed on an annual average basis.<sup>14</sup>

### 3. Baseline Establishment Rules

In respect of both reformulated gasoline (for sulphur, olefins and T-90 requirements under the Simple Model) and conventional gasoline (for all requirements), 1990 baselines are an integral element of the Gasoline Rule enforcement process. Accordingly, the Gasoline Rule contains detailed baseline establishment rules.<sup>15</sup> Baselines can be either individual (established by the entity itself) or statutory (established by the EPA and intended to reflect average 1990 United States gasoline quality), depending on the nature of the entity concerned.

#### (i) *domestic refiners*

Any domestic refiner which was in operation for at least six months in 1990 must establish an individual baseline representing the quality of gasoline produced by that refiner in 1990. The Gasoline Rule provides three methods of establishment to be used for this purpose. Under Method 1, the domestic refiner must use the quality data and volume records of its 1990 gasoline. If Method 1 data is not available, the domestic refiner must use its 1990 gasoline blendstock quality data and 1990 blendstock production records (Method 2). In the event that Method 2 data is not available, the domestic refiner must establish an individual 1990 baseline on the basis of its post-1990 gasoline blendstock and/or gasoline quality data modeled in the light of refinery changes to show 1990 gasoline composition (Method 3).

Domestic refiners that were in operation for at least six months in 1990 are not permitted to forego their individual baseline and use the statutory baseline established by the EPA. However, domestic refiners that commenced operations after 1990, or operated for less than six months during 1990, are required to use the statutory baseline established by the EPA.

<sup>13</sup>Section 211(k)(8) of the CAA.

<sup>14</sup>Section 80.90 of the Gasoline Rule.

<sup>15</sup>Section 80.91.

#### (ii) *blenders*

Blenders are required to establish an individual baseline representing the quality of their 1990 gasoline using Method 1 above. Failing this, they must use the statutory baseline established by the EPA. Blenders may not apply an individual baseline using Methods 2 or 3.

#### (iii) *importers*

Importers of foreign gasoline are required to establish an individual baseline in respect of gasoline imported by them during 1990, using Method 1. Like blenders, importers become subject to the statutory baseline if, as anticipated by the EPA, the data necessary for Method 1 is unavailable.

The Gasoline Rule does not provide for foreign refiner individual baselines, although the possible use of individual baselines for foreign refiners was examined by the EPA while drafting the Gasoline Rule. Indeed, the EPA continued to examine the possible use of individual baselines for foreign refineries after the adoption of the Gasoline Rule, and prepared its May 1994 proposal<sup>16</sup> as a result. The May 1994 proposal provided for limited use by importers of individual baselines established for foreign refineries in order to demonstrate that gasoline produced at that foreign refinery complied with the reformulated (but not conventional) gasoline standards. The individual baselines would be determined using Methods 1, 2 or 3, as for domestic refineries under the Gasoline Rule. However, the use of individual baselines in such cases would be conditioned and limited in a number of ways. The EPA's May 1994 proposal never entered into force, as the United States Congress enacted legislation in September 1994 denying the funding necessary for its implementation.

### C. The Panel Report: Its Findings and Conclusions

8.1 The Panel's overall conclusions and its recommendation are set out in the following terms:  
In the light of the findings above, the Panel concluded that the baseline establishment methods contained in Part 80 of Title 40 of the Code of Federal Regulations are not consistent with Article III:4 of the General Agreement, and cannot be justified under paragraphs (b), (d) and (g) of Article XX of the General Agreement.

8.2 The Panel *recommends* that the Dispute Settlement Body request the United States to bring this part of the Gasoline Rule into conformity with its obligations under the General Agreement.<sup>17</sup>

<sup>16</sup>40 CFR 80, 59 Fed. Reg. at 22 800 (3 May 1994).

<sup>17</sup>Panel Report at p. 47.

On route to its overall conclusions, the Panel made the following principal findings:

- (i) that the Panel's terms of reference were established after the 75 per cent rule had ceased to have any effect, and the rule had not been mentioned in the terms of reference, and that, in any case, it was unnecessary, in view of findings (ii), (iv), (v) and (vii) below, to determine whether the measure at issue was inconsistent with Article I:1 of the *General Agreement on Tariffs and Trade 1994* (the "*General Agreement*");<sup>18</sup>
- (ii) that imported and domestic gasoline were "like products" and that since, under the baseline establishment rules of the Gasoline Rule, imported gasoline was effectively prevented from benefiting from as favourable sales conditions as were afforded domestic gasoline by an individual baseline tied to the producer of a product, imported gasoline was treated "less favourably" than domestic gasoline. The baseline establishment rules of the Gasoline Rule were accordingly inconsistent with Article III:4 of the *General Agreement*;<sup>19</sup>
- (iii) that, in view of finding (ii), it was not necessary to examine the consistency of the Gasoline Rule with Article III:1;<sup>20</sup>
- (iv) that the "aspect of the baseline establishment methods" found inconsistent with Article III:4 was not justified under Article XX(b) of the *General Agreement* as "necessary to protect human, animal or plant life or health";<sup>21</sup>
- (v) that the "maintenance of discrimination between imported and domestic gasoline" contrary to Article III:4 was not justified under Article XX(d) as "necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of [the General] Agreement";<sup>22</sup>
- (vi) that clean air was an exhaustible natural resource within the meaning of Article XX(g) of the *General Agreement*;<sup>23</sup>

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<sup>18</sup>Panel Report, para. 6.19.

<sup>19</sup>Panel Report, para. 6.16.

<sup>20</sup>Panel Report, para. 6.17.

<sup>21</sup>Panel Report, para. 6.29.

<sup>22</sup>Panel Report, para. 6.33.

<sup>23</sup>Panel Report, para. 6.37.

- (vii) that the baseline establishment rules found to be inconsistent with Article III:4 could not be justified under Article XX(g) as a measure "relating to" the conservation of exhaustible natural resources;<sup>24</sup>
- (viii) that it was unnecessary, in the light of finding (vii), to determine whether the measure at issue was "made effective in conjunction with restrictions on domestic production or consumption";<sup>25</sup>
- (ix) that it was unnecessary, in the light of finding (vii), to determine whether the measure at issue met the conditions in the introductory clause of Article XX (sometimes referred to as the chapeau of Article XX);
- (x) that it was unnecessary, in view of findings (ii), (iv), (v) and (vii), to determine whether the measure at issue was inconsistent with Article XXIII:1(b) as having nullified and impaired benefits accruing under the *General Agreement*;<sup>26</sup> and
- (xi) that it was unnecessary, in the light of findings (ii), (iv), (v) and (vii), to determine whether the measure at issue was inconsistent with Articles 2.1 and 2.2 of the *Agreement on Technical Barriers to Trade* (the "*TBT Agreement*").<sup>27</sup>

## II. Issues Raised In This Appeal

### A. The Claims of Error by the United States

It is important to focus upon the subject matter of this appeal. We seek to do this first by identifying the issues which have been raised by the Appellant, the United States. In what follows we highlight those same issues by listing certain other issues dealt with in the Panel proceedings but which have *not* been brought before the Appellate Body in this appeal, and which we accordingly exclude from consideration in this Appellate Report.

In its Notice of Appeal, dated 21 February 1996, and its Appellant's Submission, dated 4 March 1996, the United States claims that the Panel erred in law, firstly, in holding that the baseline

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<sup>24</sup>Panel Report, para. 6.40.

<sup>25</sup>Panel Report, para. 6.41.

<sup>26</sup>Panel Report, para. 6.42.

<sup>27</sup>Panel Report, para. 6.43.

establishment rules of the Gasoline Rule are not justified under Article XX(g) of the *General Agreement* and, secondly, in its interpretation of Article XX as a whole.

More specifically, the United States assigns as error the ruling of the Panel that the baseline establishment rules do not constitute a "measure" "relating to" the conservation of clean air within the meaning of Article XX(g) of the *General Agreement*. Consequently, it is also the view of the United States that the Panel erred in failing to proceed further in its interpretation and application of Article XX(g), and in not finding that the baseline establishment rules satisfy the other requirements of Article XX(g) and the introductory provisions of Article XX.

The sharply limited scope of this appeal is underscored by noting the number of findings which the Panel had made but which have not been appealed from by the United States. Very briefly, the United States does not appeal from the findings or rulings made by the Panel on, or in respect of, the consistency of the baseline establishment rules with Article I:1, Article III:1, Article III:4, and Article XXIII:1(b) of the *General Agreement* and the applicability of Article XX(b) and Article XX(d) of the *General Agreement* and of the *TBT Agreement*. Understandably, the United States has also not appealed from the Panel's ruling that clean air is an exhaustible natural resource within the meaning of Article XX(g) of the *General Agreement*.

B. The Claims of the Appellees and the Arguments of the Third Participants

The Appellees, Venezuela and Brazil, submit that the Appellate Body should dismiss the United States' appeal and uphold the Panel's findings and conclusions concerning Article XX(g). In particular, Venezuela and Brazil support the Panel's finding that the measure at issue before the Panel was not one "relating to" the conservation of exhaustible natural resources. Venezuela also states that a measure can only be "relating to" or "primarily aimed at" conservation if the measure was both: (i) primarily intended to achieve a conservation goal; and (ii) had a positive conservation effect.

Venezuela argues that, as the United States has not met its burden with respect to the "relating to" requirement of Article XX(g) in this appeal, the Appellate Body may uphold the Panel Report on this issue alone, and it is not necessary to address the additional requirements of Article XX(g), nor the requirements in the Article XX chapeau.

If the Appellate Body overturns the Panel's findings on the "relating to" component of Article XX(g) and does proceed to examine the other requirements of Article XX(g), Venezuela and Brazil submit that the United States has also failed to demonstrate that those requirements have been satisfied. They argue that the measure in issue is not "made effective in conjunction with restrictions on domestic production or consumption" as the restrictions are not imposed as direct limits on the

production or consumption of clean air, but rather upon the consumption of certain kinds of gasoline. They further submit that clean air does not qualify as an "exhaustible natural resource" within the meaning of Article XX(g).

With regard to the requirements in the chapeau to Article XX, Venezuela and Brazil submit that the measure is applied in a manner which constitutes "arbitrary or unjustifiable discrimination between countries where the same conditions prevail." Venezuela argues that the measure constitutes a "disguised restriction on international trade" as well.

The Appellees also raise the conditional argument that, if the Appellate Body were to overturn the Panel's findings on Article XX(g), and not find in favour of Venezuela and Brazil as to the other requirements of Article XX, it would then need to examine their claims under the *TBT Agreement*.

The third participants, the European Communities and Norway, endorse the Panel's interpretation of "relating to" and the Panel's findings under Article XX(g). They find it difficult to accept the United States' arguments that the measure at issue was "made effective in conjunction with restrictions on domestic production or consumption," as the measure in issue did not impose restrictions on clean air. With regard to the Article XX chapeau criteria, the European Communities and Norway both submit that the measure is applied in a manner constituting "arbitrary or unjustifiable discrimination between countries where the same conditions prevail" and a "disguised restriction on international trade."

C. The Preliminary Question

A preliminary question was raised by the United States at the oral hearing concerning arguments made by Venezuela and Brazil in their respective Appellees' Submissions on the issues of whether clean air is an exhaustible natural resource within the meaning of Article XX(g) and whether the baseline establishment rules are consistent with the *TBT Agreement*. The gist of the preliminary question is that the above issues and the related arguments made by Venezuela and Brazil were not properly brought before the Appellate Body in this appeal in accordance with the *Working Procedures*. It was underscored by the United States that Venezuela and Brazil had not appealed from the ruling of the Panel on the clean air issue or from the non-ruling of the Panel on the applicability of the *TBT Agreement*. Venezuela and Brazil had not filed Appellants' Submissions under Rule 23(1) of the *Working Procedures*. Neither had Venezuela nor Brazil filed separate appeals under Rule 23(4) of the *Working Procedures*. Their arguments on these two matters had been made in their Appellees' Submissions pursuant to Rule 22 and, as Appellees, Venezuela and Brazil could not challenge the Panel's finding on the clean air issue and its non-finding on the *TBT Agreement's* applicability.

### III. The Issue of Justification Under Article XX(g) of the General Agreement

Article XX(g) needs to be set out in full:

#### Article XX

##### *General Exceptions*

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:

...

(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption;

...

#### A. "Measures"

The initial issue we are asked to look at relates to the proper meaning of the term "measures" as used both in the chapeau of Article XX and in Article XX(g). The question is whether "measures" refers to the entire Gasoline Rule or, alternatively, only to the particular provisions of the Gasoline Rule which deal with the establishment of baselines for domestic refiners, blenders and importers.

Cast in the foregoing terms, the issue does not appear to be a live one. True enough the Panel Report used differing terms, or terms of shifting reference, in designating the "measures" in different parts of the Report. The Panel Report, however, held only the baseline establishment rules of the Gasoline Rule to be inconsistent with Article III:4, to the extent that such rules provided "less favourable treatment" for imported than for domestic gasoline. These are the same provisions which the Panel evaluated, and found wanting, under the justifying provisions of Article XX(g). The Panel Report did not purport to find the Gasoline Rule itself as a whole, or any part thereof other than the baseline establishment rules, to be inconsistent with Article III:4; accordingly, there was no need at all to examine whether the whole of the Gasoline Rule or any of its other rules, was saved or justified by Article XX(g). The Panel here was following the practice of earlier panels in applying Article XX to provisions found to be inconsistent with Article III:4: the "measures" to be analyzed under Article XX are the same provisions infringing Article III:4.<sup>28</sup> These earlier panels had not interpreted "measures"

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<sup>28</sup>Canada - Administration of the Foreign Investment Review Act, BISD 30S/140, adopted 7 February 1984; United States - Section 337 of the Tariff Act of 1930, BISD 36S/345, adopted 7 November 1989; United States - Taxes on Automobiles, DS31/R (1994), unadopted.

At the oral hearing, in response to questions posed by the Appellate Body, Venezuela and Brazil confirmed that they, indeed, were not appealing the mentioned two matters. They went on, however, to state that they believed it would be within the scope of authority of the Appellate Body, if it found it necessary to do so, to address the results of the Panel's examination of those two issues.

In its Post-Hearing Memorandum, the United States asserted, among other things, that were the Appellate Body to take up the above two matters in the present appeal, unfairness would be generated *vis-à-vis* the United States and it would encourage a disregard of the *Working Procedures*. Such disregard by the Appellate Body would, it was further stated, create difficulties for third parties who would have to make up their minds to become third participants or not on the basis of the issues raised on appeal as set out in the Notice of Appeal and the Appellant's Submission. The United States itself had not raised the clean air issue and the applicability of the *TBT Agreement* in its appeal, and the United States was the only Appellant in AB-1996-1.

We find the United States' submissions on this preliminary question persuasive. The arguments raised by Venezuela and Brazil on the clean air and TBT issues may be seen to be, in effect, conditional appeals, that is, conditional on the Appellate Body's overturning the Panel's overall findings on Article XX(g) and not finding in favour of Venezuela and Brazil as to the other requirements of Article XX. This condition is not fulfilled. Even if this condition had been fulfilled, the Appellate Body would have been most reluctant to pass upon these two issues. We observe, in the first place, that the issues in fact raised by the Appellant, the United States, are not of the kind which cannot be decided without at the same time necessarily resolving the clean air issue or the applicability of the *TBT Agreement*. In the second place, to deal with those two issues, under the circumstances of this appeal, would have required the Appellate Body casually to disregard its own *Working Procedures* and to do so in the absence of a compelling reason grounded on, for instance, fundamental fairness or *force majeure*. Venezuela and Brazil could have appealed the Panel's finding and non-finding on the two matters by taking advantage of Rules 23(1) or 23(4) of the *Working Procedures* and thereby placing the Appellate Body in a position to dispose of those issues directly in one and the same appellate proceeding.

The acceptance by Venezuela and Brazil of the *Working Procedures*, and their commitment to them, is not in question. We have no option, however, but to find that the route they chose for addressing the two issues in question is not contemplated by the *Working Procedures*, and therefore, these issues are not properly the subject of this appeal.

more broadly under Article XX to include provisions not themselves found inconsistent with Article III:4. In the present appeal, no one has suggested in their final submissions that the Appellate Body should examine under Article XX any portion of the Gasoline Rule other than the baseline establishment rules held to be in conflict with Article III:4. No one has urged an interpretation of "measures" which would encompass the Gasoline Rule in its totality.<sup>29</sup>

At the oral hearing and in its Post-Hearing Memorandum, the United States complained about the designation of the baseline establishment rules in the Panel Report and by the Appellees Venezuela and Brazil, in such terms as "the difference in treatment", "the less favourable treatment" or "the discrimination." It is, of course, true that the baseline establishment rules had been found by the Panel to be inconsistent with Article III:4 of the *General Agreement*. The frequent designation of those provisions by the Panel in terms of its legal conclusion in respect of Article III:4, in the Appellate Body's view, did not serve the cause of clarity in analysis when it came to evaluating the same baseline establishment rules under Article XX(g).

B. "relating to the conservation of exhaustible natural resources"

The Panel Report took the view that clean air was a "natural resource" that could be "depleted." Accordingly, as already noted earlier, the Panel concluded that a policy to reduce the depletion of clean air was a policy to conserve an exhaustible natural resource within the meaning of Article XX(g). Shortly thereafter, however, the Panel Report also concluded that "the less favourable baseline establishments methods" were *not* primarily aimed at the conservation of exhaustible natural resources and thus fell outside the justifying scope of Article XX(g).

The Panel, addressing the task of interpreting the words "relating to", quoted with approval the following passage from the panel report in the 1987 *Herring and Salmon* case:<sup>30</sup>

<sup>29</sup>Although, in earlier submissions to the Appellate Body, the United States suggested that "the Gasoline Rule" should be examined in the context of Article XX(g), in its Post-Hearing Memorandum, dated 1 April 1996, the United States confirmed its understanding that the "measures" in issue are the baseline establishment rules contained in the Gasoline Rule.

Brazil stated, in its final submission to the Appellate Body, dated 1 April 1996, that "the measure" with which this appeal is concerned is the baseline methodology of the Gasoline Rule, not the entire rule itself." This would suggest a position similar to that adopted by the United States. Thereafter, Brazil continued to state that "Brazil and Venezuela did not challenge all portions of the Rule; they challenged only the discriminatory methods of establishing baselines."

Venezuela stated, in its summary statement, dated 29 March 1996, that "the measure to be examined is the discriminatory measure, that is, the aspect of the Gasoline Rule that denies imported gasoline the right to use the same regulatory system of baselines applicable to U.S. gasoline, namely, the system of individual baselines."

<sup>30</sup>*Canada - Measures Affecting Exports of Unprocessed Herring and Salmon*, BISD 35S/98, para. 4.6; adopted on 22 March 1988, cited in Panel Report, para. 6.39.

as the preamble of Article XX indicates, the purpose of including Article XX:(g) in the General Agreement was not to widen the scope for measures serving trade policy purposes but merely to ensure that the commitments under the General Agreement do not hinder the pursuit of policies aimed at the conservation of exhaustible natural resources. The Panel concluded for these reasons that, while a trade measure did not have to be necessary or essential to the conservation of an exhaustible natural resource, it had to be *primarily aimed* at the conservation of an exhaustible natural resource to be considered as "relating to" conservation within the meaning of Article XX:(g). (emphasis added by the Panel)

The Panel Report then went on to apply the 1987 *Herring and Salmon* reasoning and conclusion to the baseline establishment rules of the Gasoline Rule in the following manner:<sup>31</sup>

The Panel then considered whether the precise aspects of the Gasoline Rule that it had found to violate Article III -- the less favourable baseline establishments methods that adversely affected the conditions of competition for imported gasoline -- were primarily aimed at the conservation of natural resources. The Panel saw no direct connection between the less favourable treatment of imported gasoline that was chemically identical to domestic gasoline, and the US objective of improving air quality in the United States. Indeed, in the view of the Panel, being consistent with the obligation to provide no less favourable treatment would not prevent the attainment of the desired level of conservation of natural resources under the Gasoline Rule. Accordingly, it could not be said that the baseline establishment methods that afforded less favourable treatment to imported gasoline were primarily aimed at the conservation of natural resources. In the Panel's view, the above-noted lack of connection was underscored by the fact that affording treatment of imported gasoline consistent with its Article III:4 obligations would not in any way hinder the United States in its pursuit of its conservation policies under the Gasoline Rule. Indeed, the United States remained free to regulate in order to obtain whatever air quality it wished. The Panel therefore concluded that the less favourable baseline establishments methods at issue in this case were not primarily aimed at the conservation of natural resources.

It is not easy to follow the reasoning in the above paragraph of the Panel Report. In our view, there is a certain amount of opaqueness in that reasoning. The Panel starts with positing that there was "no direct connection" between the baseline establishment rules which it characterized as "less favourable treatment" of imported gasoline that was chemically identical to the domestic gasoline and "the US objective of improving air quality in the United States." Shortly thereafter, the Panel went on to conclude that "accordingly, it could not be said that the baseline establishment rules that afforded less favourable treatment to imported gasoline were *primarily aimed at* the conservation of natural resources" (emphasis added). The Panel did not try to clarify whether the phrase "direct connection" was being used as a synonym for "primarily aimed at" or whether a new and additional element (on top of "primarily aimed at") was being demanded.

<sup>31</sup>Panel Report, para. 6.40.

of interpretation has attained the status of a rule of customary or general international law.<sup>34</sup> As such, it forms part of the "customary rules of interpretation of public international law" which the Appellate Body has been directed, by Article 3(2) of the *DSU*, to apply in seeking to clarify the provisions of the *General Agreement* and the other "covered agreements" of the *Marrakesh Agreement Establishing the World Trade Organization*<sup>35</sup> (the "*WTO Agreement*"). That direction reflects a measure of recognition that the *General Agreement* is not to be read in clinical isolation from public international law.

Applying the basic principle of interpretation that the words of a treaty, like the *General Agreement*, are to be given their ordinary meaning, in their context and in the light of the treaty's object and purpose, the Appellate Body observes that the Panel Report failed to take adequate account of the words actually used by Article XX in its several paragraphs. In enumerating the various categories of governmental acts, laws or regulations which WTO Members may carry out or promulgate in pursuit of differing legitimate state policies or interests outside the realm of trade liberalization, Article XX uses different terms in respect of different categories:

"necessary" - in paragraphs (a), (b) and (d); "essential" - in paragraph (j);  
"relating to" - in paragraphs (c), (e) and (g); "for the protection of" - in paragraph (f);  
"in pursuance of" - in paragraph (h); and "involving" - in paragraph (i).

It does not seem reasonable to suppose that the WTO Members intended to require, in respect of each and every category, the same kind or degree of connection or relationship between the measure under appraisal and the state interest or policy sought to be promoted or realized.

At the same time, Article XX(g) and its phrase, "relating to the conservation of exhaustible natural resources," need to be read in context and in such a manner as to give effect to the purposes and objects of the *General Agreement*. The context of Article XX(g) includes the provisions of the rest of the *General Agreement*, including in particular Articles I, III and XI; conversely, the context of Articles I and III and XI includes Article XX. Accordingly, the phrase "relating to the conservation of exhaustible natural resources" may not be read so expansively as seriously to subvert the purpose and object of Article III:4. Nor may Article III:4 be given so broad a reach as effectively to emasculate Article XX(g) and the policies and interests it embodies. The relationship between the affirmative commitments set out in, e.g., Articles I, III and XI, and the policies and interests embodied in the

<sup>34</sup>See, e.g., *Territorial Dispute Case (Libyan Arab Jamahiriya v. Chad)*, (1994), I.C.J. Reports p. 6 (International Court of Justice); *Golder v. United Kingdom*, ECHR, Series A, (1995) no. 18 (European Court of Human Rights); *Restrictions to the Death Penalty Cases*, (1986) 70 International Law Reports 449 (Inter-American Court of Human Rights); Jiménez de Aréchaga, "International Law in the Past Third of a Century" (1978-I) 159 *Recueil des Cours* 1, p. 42; D. Carreau, *Droit International* (3<sup>e</sup> ed., 1991) p. 140; Oppenheim's *International Law* (9th ed., Jennings and Watts, eds. 1992) Vol. 1, pp. 1271-1275.

<sup>35</sup>Done at Marrakesh, Morocco, 15 April 1994.

One problem with the reasoning in that paragraph is that the Panel asked itself whether the "less favourable treatment" of imported gasoline was "primarily aimed at" the conservation of natural resources, rather than whether the "measure", i.e. the baseline establishment rules, were "primarily aimed at" conservation of clean air. In our view, the Panel here was in error in referring to its legal conclusion on Article III:4 instead of the measure in issue. The result of this analysis is to turn Article XX on its head. Obviously, there had to be a finding that the measure provided "less favourable treatment" under Article III:4 before the Panel examined the "General Exceptions" contained in Article XX. That, however, is a conclusion of law. The chapeau of Article XX makes it clear that it is the "measures" which are to be examined under Article XX(g), and not the legal finding of "less favourable treatment."

Furthermore, the Panel Report appears to have utilized a conclusion it had reached earlier in holding that the baseline establishment rules did not fall within the justifying terms of Articles XX(b); i.e. that the baseline establishment rules were not "necessary" for the protection of human, animal or plant life. The Panel Report, it will be recalled, found that the baseline establishment rules had not been shown by the United States to be "necessary" under Article XX(b) since alternative measures either consistent or less inconsistent with the *General Agreement* were reasonably available to the United States for achieving its aim of protecting human, animal or plant life.<sup>32</sup> In other words, the Panel Report appears to have applied the "necessary" test not only in examining the baseline establishment rules under Article XX(b), but also in the course of applying Article XX(g).

A principal difficulty, in the view of the Appellate Body, with the Panel Report's application of Article XX(g) to the baseline establishment rules is that the Panel there overlooked a fundamental rule of treaty interpretation. This rule has received its most authoritative and succinct expression in the *Vienna Convention on the Law of Treaties* (the "*Vienna Convention*")<sup>33</sup> which provides in relevant part:

#### ARTICLE 31

##### *General rule of interpretation.*

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

The "general rule of interpretation" set out above has been relied upon by all of the participants and third participants, although not always in relation to the same issue. That general rule

<sup>32</sup>Panel Report, paras. 6.25-6.28.

<sup>33</sup>(1969), 8 *International Legal Materials* 679.

"General Exceptions" listed in Article XX, can be given meaning within the framework of the *General Agreement* and its object and purpose by a treaty interpreter only on a case-to-case basis, by careful scrutiny of the factual and legal context in a given dispute, without disregarding the words actually used by the WTO Members themselves to express their intent and purpose.

The 1987 *Herring and Salmon* report, and the Panel Report itself, gave some recognition to the foregoing considerations of principle. As earlier noted, the Panel Report quoted the following excerpt from the *Herring and Salmon* report:

as the preamble of Article XX indicates, the purpose of including Article XX(g) in the General Agreement was not to widen the scope for measures serving trade policy purposes but merely to ensure that the commitments under the *General Agreement do not hinder the pursuit of policies* aimed at the conservation of exhaustible natural resources.<sup>36</sup> (emphasis added)

All the participants and the third participants in this appeal accept the propriety and applicability of the view of the *Herring and Salmon* report and the Panel Report that a measure must be "primarily aimed at" the conservation of exhaustible natural resources in order to fall within the scope of Article XX(g).<sup>37</sup> Accordingly, we see no need to examine this point further, save, perhaps, to note that the phrase "primarily aimed at" is not itself treaty language and was not designed as a simple litmus test for inclusion or exclusion from Article XX(g).

Against this background, we turn to the specific question of whether the baseline establishment rules are appropriately regarded as "primarily aimed at" the conservation of natural resources for the purposes of Article XX(g). We consider that this question must be answered in the affirmative.

The baseline establishment rules, taken as a whole (that is, the provisions relating to establishment of baselines for domestic refiners, along with the provisions relating to baselines for blenders and importers of gasoline), need to be related to the "non-degradation" requirements set out elsewhere in the Gasoline Rule. Those provisions can scarcely be understood if scrutinized strictly by themselves, totally divorced from other sections of the Gasoline Rule which certainly constitute part of the context of these provisions. The baseline establishment rules whether individual or statutory, were designed to permit scrutiny and monitoring of the level of compliance of refiners, importers and blenders with the "non-degradation" requirements. Without baselines of some kind, such scrutiny would not be possible and the Gasoline Rule's objective of stabilizing and preventing further deterioration of the level of air pollution prevailing in 1990, would be substantially frustrated. The

<sup>36</sup>Canada - Measures Affecting Exports of Unprocessed Herring and Salmon, BISD 35S/98, para. 4.6; adopted 22 March 1988, cited in Panel Report, para. 6.39.

<sup>37</sup>We note that the same interpretation has been applied in two recent unadopted panel reports: *United States - Restrictions on Imports of Tuna*, DS29/R (1994); *United States - Taxes on Automobiles*, DS31/R (1994).

relationship between the baseline establishment rules and the "non-degradation" requirements of the Gasoline Rule is not negated by the inconsistency, found by the Panel, of the baseline establishment rules with the terms of Article III:4. We consider that, given that substantial relationship, the baseline establishment rules cannot be regarded as merely incidentally or inadvertently aimed at the conservation of clean air in the United States for the purposes of Article XX(g).

C. "if such measures are made effective in conjunction with restrictions on domestic production or consumption"

The Panel did not find it necessary to deal with the issue of whether the baseline establishment rules "are made effective in conjunction with restrictions on domestic production or consumption", since it had earlier concluded that those rules had not even satisfied the preceding requirement of "relating to" in the sense of being "primarily aimed at" the conservation of clean air. Having been unable to concur with that earlier conclusion of the Panel, we must now address this second requirement of Article XX(g), the United States having, in effect, appealed from the failure of the Panel to proceed further with its inquiry into the availability of Article XX(g) as a justification for the baseline establishment rules.

The claim of the United States is that the second clause of Article XX(g) requires that the burdens entailed by regulating the level of pollutants in the air emitted in the course of combustion of gasoline, must not be imposed solely on, or in respect of, imported gasoline.

On the other hand, Venezuela and Brazil refer to prior panel reports which include statements to the effect that to be deemed as "made effective in conjunction with restrictions on domestic production or consumption", a measure must be "primarily aimed at" making effective certain restrictions on domestic production or consumption.<sup>38</sup> Venezuela and Brazil also argue that the United States has failed to show the existence of restrictions on domestic production or consumption of a natural resource under the Gasoline Rule since clean air was not an exhaustible natural resource within the meaning of Article XX(g). Venezuela contends, finally, that the United States has not discharged its burden of showing that the baseline establishment rules make the United States' regulatory scheme "effective." The claim of Venezuela is, in effect, that to be properly regarded as "primarily aimed at" the conservation of natural resources, the baseline establishment rules must not only "reflect a conservation purpose" but also be shown to have had "some positive conservation effect."<sup>39</sup>

<sup>38</sup>Canada - Measures Affecting Exports of Unprocessed Herring and Salmon, BISD 35S/98, paras. 4.6-4.7; adopted 22 March 1988. Also, *United States - Restrictions on Imports of Tuna*, DS29/R (1994), unadopted; and *United States - Taxes on Automobiles*, DS31/R (1994), unadopted.

<sup>39</sup>Venezuela's Appellee's Submission, dated 18 March 1996; Venezuela's Statement at the Oral Hearing, dated 27 March 1996.

The Appellate Body considers that the basic international law rule of treaty interpretation, discussed earlier, that the terms of a treaty are to be given their ordinary meaning, in context, so as to effectuate its object and purpose, is applicable here, too. Viewed in this light, the ordinary or natural meaning of "made effective" when used in connection with a measure - a governmental act or regulation - may be seen to refer to such measure being "operative", as "in force", or as having "come into effect."<sup>40</sup> Similarly, the phrase "in conjunction with" may be read quite plainly as "together with" or "jointly with."<sup>41</sup> Taken together, the second clause of Article XX(g) appears to us to refer to governmental measures like the baseline establishment rules being promulgated or brought into effect together with restrictions on domestic production or consumption of natural resources. Put in a slightly different manner, we believe that the clause "if such measures are made effective in conjunction with restrictions on domestic product or consumption" is appropriately read as a requirement that the measures concerned impose restrictions, not just in respect of imported gasoline but also with respect to domestic gasoline. The clause is a requirement of *even-handedness* in the imposition of restrictions, in the name of conservation, upon the production or consumption of exhaustible natural resources.

There is, of course, no textual basis for requiring identical treatment of domestic and imported products. Indeed, where there is identity of treatment - constituting real, not merely formal, equality of treatment - it is difficult to see how inconsistency with Article III:4 would have arisen in the first place. On the other hand, if *no* restrictions on domestically-produced like products are imposed at all, and all limitations are placed upon imported products *alone*, the measure cannot be accepted as primarily or even substantially designed for implementing conservationist goals.<sup>42</sup> The measure would simply be naked discrimination for protecting locally-produced goods.

In the present appeal, the baseline establishment rules affect both domestic gasoline and imported gasoline, providing for - generally speaking - individual baselines for domestic refiners and blenders and statutory baselines for importers. Thus, restrictions on the consumption or depletion of clean air by regulating the domestic production of "dirty" gasoline are established jointly with corresponding restrictions with respect to imported gasoline. That imported gasoline has been determined to have been accorded "less favourable treatment" than the domestic gasoline in terms of

<sup>40</sup>The New Shorter Oxford English Dictionary on Historical Principles (L. Brown, ed., 1993), Vol. I, p. 786.

<sup>41</sup>*Id.*, p. 481.

<sup>42</sup>Some illustration is offered in the *Herring and Salmon* case which involved, *inter alia*, a Canadian prohibition of exports of unprocessed herring and salmon. This prohibition effectively constituted a ban on purchase of certain unprocessed fish by foreign processors and consumers while imposing no corresponding ban on purchase of unprocessed fish by domestic processors and consumers. The prohibitions appeared to be designed to protect domestic processors by giving them exclusive access to fresh fish and at the same time denying such raw material to foreign processors. The Panel concluded that these export prohibitions were not justified by Article XX(g). BISD 35S/98, para. 5.1, adopted 22 March 1988. See also the Panel Report in the *United States - Prohibition of Imports of Tuna and Tuna Products from Canada*, BISD 29S/91, paras. 4.10-4.12; adopted on 22 February 1982.

Article III:4, is not material for purposes of analysis under Article XX(g). It might also be noted that the second clause of Article XX(g) speaks disjunctively of "domestic production *or* consumption."

We do not believe, finally, that the clause "if made effective in conjunction with restrictions on domestic production or consumption" was intended to establish an empirical "effects test" for the availability of the Article XX(g) exception. In the first place, the problem of determining causation, well-known in both domestic and international law, is always a difficult one. In the second place, in the field of conservation of exhaustible natural resources, a substantial period of time, perhaps years, may have to elapse before the effects attributable to implementation of a given measure may be observable. The legal characterization of such a measure is not reasonably made contingent upon occurrence of subsequent events. We are not, however, suggesting that consideration of the predictable effects of a measure is never relevant. In a particular case, should it become clear that realistically, a specific measure cannot in any possible situation have any positive effect on conservation goals, it would very probably be because that measure was not designed as a conservation regulation to begin with. In other words, it would not have been "primarily aimed at" conservation of natural resources at all.

#### IV. The Introductory Provisions of Article XX of the General Agreement: Applying the Chapeau of the General Exceptions

Having concluded, in the preceding section, that the baseline establishment rules of the Gasoline Rule fall within the terms of Article XX(g), we come to the question of whether those rules also meet the requirements of the chapeau of Article XX. In order that the justifying protection of Article XX may be extended to it, the measure at issue must not only come under one or another of the particular exceptions - paragraphs (a) to (j) - listed under Article XX; it must also satisfy the requirements imposed by the opening clauses of Article XX. The analysis is, in other words, two-tiered: first, provisional justification by reason of characterization of the measure under XX(g); second, further appraisal of the same measure under the introductory clauses of Article XX.

The chapeau by its express terms addresses, not so much the questioned measure or its specific contents as such, but rather the manner in which that measure is applied.<sup>43</sup> It is, accordingly, important to underscore that the purpose and object of the introductory clauses of Article XX is generally the prevention of "abuse of the exceptions of [what was later to become] Article [XX]." <sup>44</sup>This insight drawn from the drafting history of Article XX is a valuable one. The chapeau is animated

<sup>43</sup>This was noted in the Panel Report on *United States - Imports of Certain Automotive Spring Assemblies*, BISD 30S/107, para. 56; adopted on 26 May 1983.

<sup>44</sup>EPCT/C.11/50, p. 7; quoted in *Analytical Index: Guide to GATT Law and Practice*, Volume I, p. 564 (1995).

by the principle that while the exceptions of Article XX may be invoked as a matter of legal right, they should not be so applied as to frustrate or defeat the legal obligations of the holder of the right under the substantive rules of the *General Agreement*. If those exceptions are not to be abused or misused, in other words, the measures falling within the particular exceptions must be applied reasonably, with due regard both to the legal duties of the party claiming the exception and the legal rights of the other parties concerned.

The burden of demonstrating that a measure provisionally justified as being within one of the exceptions set out in the individual paragraphs of Article XX does not, in its application, constitute abuse of such exception under the chapeau, rests on the party invoking the exception. That is, of necessity, a heavier task than that involved in showing that an exception, such as Article XX(g), encompasses the measure at issue.

The enterprise of applying Article XX would clearly be an unprofitable one if it involved no more than applying the standard used in finding that the baseline establishment rules were inconsistent with Article III:4. That would also be true if the finding were one of inconsistency with some other substantive rule of the *General Agreement*. The provisions of the chapeau cannot logically refer to the same standard(s) by which a violation of a substantive rule has been determined to have occurred. To proceed down that path would be both to empty the chapeau of its contents and to deprive the exceptions in paragraphs (a) to (j) of meaning. Such recourse would also confuse the question of whether inconsistency with a substantive rule existed, with the further and separate question arising under the chapeau of Article XX as to whether that inconsistency was nevertheless justified. One of the corollaries of the "general rule of interpretation" in the *Vienna Convention* is that interpretation must give meaning and effect to all the terms of a treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.<sup>45</sup>

The chapeau, it will be seen, prohibits such application of a measure at issue (otherwise falling within the scope of Article XX(g)) as would constitute

- (a) "arbitrary discrimination" (between countries where the same conditions prevail);
- (b) "unjustifiable discrimination" (with the same qualifier); or
- (c) "disguised restriction" on international trade.

The text of the chapeau is not without ambiguity, including one relating to the field of application of the standards it contains: the arbitrary or unjustifiable discrimination standards and the disguised restriction on international trade standard. It may be asked whether these standards do not have different fields of application. Such a question was put to the United States in the course of the oral hearing. It was asked whether the words incorporated into the first two standards "between countries where the same conditions prevail" refer to conditions in importing and exporting countries, or only to conditions in exporting countries. The reply of the United States was to the effect that it interpreted that phrase as referring to both the exporting countries and importing countries and as between exporting countries. It also said that the language spoke for itself, but there was no reference to third parties; while some thought that this was only between exporting countries *inter se*, there is no support in the text for that view. No such question was put to the United States concerning the field of application of the third standard - disguised restriction on international trade. But the United States put forward arguments designed to show that in the case under appeal, it had met all the standards set forth in the chapeau. In doing so, it clearly proceeded on the assumption that, whatever else they might relate to in another case, they were relevant to a case of national treatment where the Panel had found a violation of Article III:4. At no point in the appeal was that assumption challenged by Venezuela or Brazil. Venezuela argued that the United States had failed to meet all the standards contained in the chapeau. So did Norway and the European Communities as third participants. In short, the field of application of these standards was not at issue.

The assumption on which all the participants proceeded is buttressed by the fact that the chapeau says that "*nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures ...*" The exceptions listed in Article XX thus relate to all of the obligations under the *General Agreement*: the national treatment obligation and the most-favoured-nation obligation, of course, but others as well. Effect is more easily given to the words "nothing in this Agreement", and Article XX as a whole including its chapeau more easily integrated into the remainder of the *General Agreement*, if the chapeau is taken to mean that the standards it sets forth are applicable to all of the situations in which an allegation of a violation of a substantive obligation has been made and one of the exceptions contained in Article XX has in turn been claimed.

Against this background, we see no need to decide the matter of the field of application of the standards set forth in the chapeau nor to make a ruling at variance with the common understanding of the participants.<sup>46</sup>

<sup>46</sup>We note in this connection that two previous panels had occasion to apply the chapeau. In *United States - Imports of Certain Automotive Spring Assemblies*, BISD 30S/107, adopted on 26 May 1983, the panel had before it a ban on imports, and an exclusion order of the United States' International Trade Commission, of certain automotive spring assemblies which the Commission had found, under Section 337 of the Tariff Act of 1930, to have infringed valid United States patents. The panel there held that the exclusion order had *not* been applied in a manner which would constitute a means of "arbitrary or unjustifiable discrimination against countries where the same conditions prevail," because that order was directed against imports of infringing assemblies "from all foreign sources, and not just from Canada." At the same time, the same order was

<sup>45</sup>*E.g., Corfu Channel Case* (1949) I.C.J. Reports, p.24 (International Court of Justice); *Territorial Dispute Case* (Libyan Arab Jamahiriya v. Chad) (1994) I.C.J. Reports, p. 23 (International Court of Justice); 1966 Yearbook of the International Law Commission, Vol. II at 219; *Oppenheim's International Law* (9th ed., Jennings and Watts eds., 1992), Volume 1, 1280-1281; P. Dallier and A. Pellet, *Droit International Public*, 5è ed. (1994) para. 17.2); D. Carreau, *Droit International*, (1994) para. 369.

"Arbitrary discrimination", "unjustifiable discrimination" and "disguised restriction" on international trade may, accordingly, be read side-by-side; they impart meaning to one another. It is clear to us that "disguised restriction" includes *disdiscrimination* in international trade. It is equally clear that *concealed* or *unannounced* restriction or discrimination in international trade does not exhaust the meaning of "disguised restriction." We consider that "disguised restriction", whatever else it covers, may properly be read as embracing restrictions amounting to arbitrary or unjustifiable discrimination in international trade taken under the guise of a measure formally within the terms of an exception listed in Article XX. Put in a somewhat different manner, the kinds of considerations pertinent in deciding whether the application of a particular measure amounts to "arbitrary or unjustifiable discrimination", may also be taken into account in determining the presence of a "disguised restriction" on international trade. The fundamental theme is to be found in the purpose and object of avoiding abuse or illegitimate use of the exceptions to substantive rules available in Article XX.

There was more than one alternative course of action available to the United States in promulgating regulations implementing the CAA. These included the imposition of statutory baselines without differentiation as between domestic and imported gasoline. This approach, if properly implemented, could have avoided any discrimination at all. Among the other options open to the United States was to make available individual baselines to foreign refiners as well as domestic refiners. The United States has put forward a series of reasons why either of these courses was not, in its view, realistically open to it and why, instead, it had to devise and apply the baseline establishment rules contained in the Gasoline Rule.

(...continued)

also examined and found *not* to be "a disguised restriction on international trade." *Id.*, paras. 54-56. See also *United States - Prohibition of Imports of Tuna and Tuna Products*, BISD 29S/91, para. 4-8; adopted 22 February 1982.

It may be observed that the term "countries" in the chapeau is textually unqualified; it does not say "foreign countries", as did Article 4 of the 1927 League of Nations *International Convention for the Abolition of Import and Export Prohibitions and Restrictions*, 97 L.N.T.S. 393. Neither does the chapeau say "third countries" as did, e.g., bilateral trade agreements negotiated by the United States under the 1934 *Reciprocal Trade Agreements Act*; e.g. the *Trade Agreement between the United States of America and Canada*, 15 November 1935, 168 L.N.T.S. 356 (1936). These earlier treaties are here noted, not as pertaining to the *travaux préparatoires* of the *General Agreement*, but simply to show how in comparable treaties, a particular intent was expressed with words not found in printer's ink in the *General Agreement*.

In explaining why individual baselines for foreign refiners had not been put in place, the United States laid heavy stress upon the difficulties which the EPA would have had to face. These difficulties related to anticipated administrative problems that individual baselines for foreign refiners would have generated. This argument was made succinctly by the United States in the following terms:

Verification on foreign soil of foreign baselines, and subsequent enforcement actions, present substantial difficulties relating to problems arising whenever a country exercises enforcement jurisdiction over foreign persons. In addition, even if individual baselines were established for several foreign refiners, the importer would be tempted to claim the refinery of origin that presented the most benefits in terms of baseline restrictions, and tracking the refinery or origin would be very difficult because gasoline is a fungible commodity. The United States should not have to prove that it cannot verify information and enforce its regulations in every instance in order to show that the same enforcement conditions do not prevail in the United States and other countries ... The impracticability of verification and enforcement of foreign refiner baselines in this instance shows that the "discrimination" is based on serious, not arbitrary or unjustifiable, concerns stemming from different conditions between enforcement of its laws in the United States and abroad.<sup>47</sup>

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<sup>47</sup>Para. 55 of the Appellant's Submission, dated 4 March 1996. The United States was in effect making the same point when, at pages 11 and 12 of its Post-Hearing Memorandum, it argued that the conditions were not the same as between the United States, on the one hand, and Venezuela and Brazil on the other.

Thus, according to the United States, imported gasoline was relegated to the more exacting statutory baseline requirement because of these difficulties of verification and enforcement. The United States stated that verification and enforcement of the Gasoline Rule's requirements for imported gasoline are "much easier when the statutory baseline is used" and that there would be a "dramatic difference" in the burden of administering requirements for imported gasoline if individual baselines were allowed.<sup>48</sup>

While the anticipated difficulties concerning verification and subsequent enforcement are doubtless real to some degree, the Panel viewed them as insufficient to justify the denial to foreign refiners of individual baselines permitted to domestic refiners. The Panel said:

While the Panel agreed that it would be necessary under such a system to ascertain the origin of gasoline, the Panel could not conclude that the United States had shown that this could not be achieved by other measures reasonably available to it and consistent or less inconsistent with the General Agreement. Indeed, the Panel noted that a determination of origin would often be feasible. The Panel examined, for instance, the case of a direct shipment to the United States. It considered that there was no reason to believe that, given the usual measures available in international trade for determination of origin and tracking of goods (including documentary evidence and third party verification) there was any particular difficulty sufficient to warrant the demands of the baseline establishment methods applied by the United States.<sup>49</sup>

...

In the view of the Panel, the United States had reasonably available to it data for, and measures of, verification and assessment which were consistent or less inconsistent with Article III:4. For instance, although foreign data may be formally less subject to complete control by US authorities, this did not amount to establishing that foreign data could not in any circumstances be sufficiently reliable to serve U.S. purposes. This, however, was the practical effect of the application of the Gasoline Rule. In the Panel's view, the United States had not demonstrated that data available from foreign refiners was inherently less susceptible to established techniques of checking, verification, assessment and enforcement than data for other trade in goods subject to US regulation. The nature of the data in this case was similar to data relied upon by the United States in other contexts, including, for example, under the application of antidumping laws. In an antidumping case, only when the information was not supplied or deemed unverifiable did the United States turn to other information. If a similar practice were to be applied in the case of the Gasoline Rule, then importers could, for instance, be permitted to use the individual baselines of foreign refiners for imported gasoline from those refiners, with the statutory baseline being applied only when the source of imported gasoline could not be determined or a baseline could not be established because of an absence of data.<sup>50</sup>

<sup>48</sup>Supplementary responses by the United States to certain questions of the Appellate Body, dated 1 April 1996.

<sup>49</sup>Panel Report, para. 6.26.

<sup>50</sup>Panel Report, para. 6.28.

We agree with the finding above made in the Panel Report. There are, as the Panel Report found, established techniques for checking, verification, assessment and enforcement of data relating to imported goods, techniques which in many contexts are accepted as adequate to permit international trade - trade between territorial sovereigns - to go on and grow. The United States must have been aware that for these established techniques and procedures to work, cooperative arrangements with both foreign refiners and the foreign governments concerned would have been necessary and appropriate. At the oral hearing, in the course of responding to an enquiry as to whether the EPA could have adapted, for purposes of establishing individual refinery baselines for foreign refiners, procedures for verification of information found in U.S. antidumping laws, the United States said that "in the absence of refinery cooperation and the possible absence of foreign government cooperation as well", it was unlikely that the EPA auditors would be able to conduct the on-site audit reviews necessary to establish even the overall quality of refineries' 1990 gasoline.<sup>51</sup> From this statement, there arises a strong implication, it appears to the Appellate Body, that the United States had not pursued the possibility of entering into cooperative arrangements with the governments of Venezuela and Brazil or, if it had, not to the point where it encountered governments that were unwilling to cooperate. The record of this case sets out the detailed justifications put forward by the United States. But it does not reveal what, if any, efforts had been taken by the United States to enter into appropriate procedures in cooperation with the governments of Venezuela and Brazil so as to mitigate the administrative problems pleaded by the United States.<sup>52</sup> The fact that the United States Congress might have intervened, as it did later intervene, in the process by denying funding, is beside the point: the United States, of course, carries responsibility for actions of both the executive and legislative departments of government.

In its submissions, the United States also explained why the statutory baseline requirement was not imposed on domestic refiners as well. Here, the United States stressed the problems that domestic refineries would have faced had they been required to comply with the statutory baseline. The Panel Report summarized the United States' argument in the following terms:

<sup>51</sup>Supplementary responses to the United States to certain questions of the Appellate Body, dated 1 April 1996.

<sup>52</sup>While it is not for the Appellate Body to speculate where the limits of effective international cooperation are to be found, reference may be made to a number of precedents that the United States (and other countries) have considered it prudent to use to help overcome problems confronting enforcement agencies by virtue of the fact that the relevant law and the authority of the enforcement of the agency does not hold sway beyond national borders. During the course of the oral hearings, attention was drawn to the fact that in addition to the antidumping law referred to by the Panel in the passage cited above, there were other US regulatory laws of this kind, *e.g.*, in the field of anti-trust law, securities exchange law and tax law. There are cooperative agreements entered into by the US and other governments to help enforce regulatory laws of the kind mentioned and to obtain data from abroad. There are such agreements, *inter alia*, in the anti-trust and tax areas. There are also, within the framework of the WTO, the *Agreement on the Implementing Measures (the "SCM Agreement")* and the *Agreement on Pre-shipment Inspection*, all of which constitute recognition of the frequency and significance of international cooperation of this sort.

The United States concluded that, contrary to Venezuela's and Brazil's claim, Article XX did not require adoption of the statutory baseline as a national standard even if the difficulties associated with the establishment of individual baselines for importers were insurmountable. Application of the statutory baseline to domestic producers of reformulated and conventional gasoline in 1995 would have been *physically and financially impossible because of the magnitude of the changes required in almost all US refineries; it thus would have caused a substantial delay in the programme*. Weighing the feasibility of policy options in economic or technical terms in order to meet an environmental objective was a legitimate consideration, and did not, in itself, constitute protectionism, as alleged by Venezuela and Brazil. Article XX did not require a government to choose the most expensive possible way to regulate its environment.<sup>53</sup> (emphasis added)

Clearly, the United States did not feel it feasible to require its domestic refiners to incur the physical and financial costs and burdens entailed by immediate compliance with a statutory baseline. The United States wished to give domestic refiners time to restructure their operations and adjust to the requirements in the Gasoline Rule. This may very well have constituted sound domestic policy from the viewpoint of the EPA and U.S. refiners. At the same time we are bound to note that, while the United States counted the costs for its domestic refiners of statutory baselines, there is nothing in the record to indicate that it did other than disregard that kind of consideration when it came to foreign refiners.

We have above located two omissions on the part of the United States: to explore adequately means, including in particular cooperation with the governments of Venezuela and Brazil, of mitigating the administrative problems relied on as justification by the United States for rejecting individual baselines for foreign refiners; and to count the costs for foreign refiners that would result from the imposition of statutory baselines. In our view, these two omissions go well beyond what was necessary for the Panel to determine that a violation of Article III:4 had occurred in the first place. The resulting discrimination must have been foreseen, and was not merely inadvertent or unavoidable. In the light of the foregoing, our conclusion is that the baseline establishment rules in the Gasoline Rule, in their application, constitute "unjustifiable discrimination" and a "disguised restriction on international trade." We hold, in sum, that the baseline establishment rules, although within the terms of Article XX(g), are not entitled to the justifying protection afforded by Article XX as a whole.

## V. FINDINGS AND CONCLUSIONS

For the reasons set out in the preceding sections of this report, the Appellate Body has reached the following conclusions:

(a) the Panel erred in law in its conclusion that the baseline establishment rules contained in Part 80 of Title 40 of the Code of Federal Regulations did not fall within the terms of Article XX(g) of the *General Agreement*;

(b) the Panel accordingly also erred in law in failing to decide whether the baseline establishment rules contained in Part 80 of Title 40 of the Code of Federal Regulations fell within the ambit of the chapeau of Article XX of the *General Agreement*;

(c) the baseline establishment rules contained in Part 80 of Title 40 of the Code of Federal Regulations fail to meet the requirements of the chapeau of Article XX of the *General Agreement*, and accordingly are not justified under Article XX of the *General Agreement*.

The foregoing legal conclusions modify the conclusions of the Panel as set out in paragraph 8.1 of its Report. The Appellate Body's conclusions leave intact the conclusions of the Panel that were not the subject of appeal.

The Appellate Body *recommends* that the Dispute Settlement Body request the United States to bring the baseline establishment rules contained in Part 80 of Title 40 of the Code of Federal Regulations into conformity with its obligations under the *General Agreement*.

It is of some importance that the Appellate Body point out what this does *not* mean. It does not mean, or imply, that the ability of any WTO Member to take measures to control air pollution or, more generally, to protect the environment, is at issue. That would be to ignore the fact that Article XX of the *General Agreement* contains provisions designed to permit important state interests - including the protection of human health, as well as the conservation of exhaustible natural resources - to find expression. The provisions of Article XX were not changed as a result of the Uruguay Round of Multilateral Trade Negotiations. Indeed, in the preamble to the *WTO Agreement* and in the *Decision on Trade and Environment*,<sup>54</sup> there is specific acknowledgement to be found about the importance of coordinating policies on trade and the environment. WTO Members have a large measure of autonomy to determine their own policies on the environment (including its relationship with trade), their environmental objectives and the environmental legislation they enact and implement. So far as concerns the WTO, that autonomy is circumscribed only by the need to respect the requirements of the *General Agreement* and the other covered agreements.

<sup>53</sup>Panel Report, para. 3.52.

<sup>54</sup>Adopted by Ministers at the Meeting of the Trade Negotiations Committee in Marrakesh on 14 April 1994.

Signed in the original at Geneva this 22nd day of April 1996 by:

\_\_\_\_\_  
Florentino P. Feliciano  
Presiding Member

\_\_\_\_\_  
\_\_\_\_\_  
Christopher Beeby  
Member  
Mitsuo Matsushita  
Member

**World Trade Organization**

**Japan – Taxes on Alcoholic Beverages**

**Report of the Appellate Body, 4 October 1996**

# WORLD TRADE ORGANIZATION

WT/DS8/AB/R  
WT/DS10/AB/R  
WT/DS11/AB/R  
4 October 1996

(96-3951)

## Appellate Body

## WORLD TRADE ORGANIZATION APPELLATE BODY

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*Japan - Taxes on Alcoholic Beverages*

AB-1996-2

Japan, Appellant/Appellee  
United States, Appellant/Appellee

Present:

Canada, Appellee  
European Communities, Appellee

Lacarte-Muró, Presiding Member  
Bacchus, Member  
El-Naggar, Member

### Japan - Taxes on Alcoholic Beverages

AB-1996-2

#### A. Introduction

Japan and the United States appeal from certain issues of law and legal interpretations in the Panel Report, *Japan - Taxes on Alcoholic Beverages*<sup>1</sup> (the "Panel Report"). That Panel (the "Panel") was established to consider complaints by the European Communities, Canada and the United States against Japan relating to the Japanese Liquor Tax Law (Shuzeiho), Law No. 6 of 1953 as amended (the "Liquor Tax Law").<sup>2</sup>

The Panel Report was circulated to the Members of the World Trade Organization (the "WTO") on 11 July 1996. It contains the following conclusions:

Report of the Appellate Body

(i) Shochu and vodka are like products and Japan, by taxing the latter in excess of the former, is in violation of its obligation under Article III:2, first sentence, of the General Agreement on Tariffs and Trade 1994.

(ii) Shochu, whisky, brandy, rum, gin, genever, and liqueurs are "directly competitive or substitutable products" and Japan, by not taxing them similarly, is in violation of its obligation under

<sup>1</sup>WT/DS8/R, WT/DS10/R, WT/DS11/R.

<sup>2</sup>Norway originally reserved its right as a third party to the dispute but subsequently informed the Panel that it was withdrawing its request to participate as a third party.

Article III:2, second sentence, of the General Agreement on Tariffs and Trade 1994.<sup>3</sup>

The Panel made the following recommendations:

7.2 The Panel recommends that the Dispute Settlement Body request Japan to bring the Liquor Tax Law into conformity with its obligations under the General Agreement on Tariffs and Trade 1994.<sup>4</sup>

On 8 August 1996, Japan notified the Dispute Settlement Body<sup>5</sup> of the WTO of its decision to appeal certain issues of law covered in the Panel Report and legal interpretations developed by the Panel, pursuant to paragraph 4 of Article 16 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU") and filed a Notice of Appeal with the Appellate Body, pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "*Working Procedures*").<sup>6</sup> On 19 August 1996, Japan filed an appellant's submission.<sup>7</sup> On 23 August 1996, the United States filed an appellant's submission pursuant to Rule 23(1) of the *Working Procedures*. The European Communities, Canada and the United States submitted appellees' submissions pursuant to Rule 22 of the *Working Procedures*, on 2 September 1996. That same day, Japan submitted an appellee's submission pursuant to Rule 23(3) of the *Working Procedures*.

The oral hearing contemplated by Rule 27 of the *Working Procedures* was held on 9 September 1996. The participants presented their arguments and answered questions from the Division of the Appellate Body hearing the appeal (the "Division"). The participants answered most of these questions orally at the hearing. They answered some in writing.<sup>8</sup> The Division gave each participant an opportunity to respond to the written post-hearing memoranda of the other participants.<sup>9</sup>

## B. Arguments of Participants

### 1. Japan

<sup>3</sup>Panel Report, para. 7.1.

<sup>4</sup>Panel Report, para. 7.2.

<sup>5</sup>WT/DS8/9, WT/DS10/9, WT/DS11/6.

<sup>6</sup>WT/AB/WP/1.

<sup>7</sup>Pursuant to Rule 21(1) of the *Working Procedures*.

<sup>8</sup>Pursuant to Rule 28(1) of the *Working Procedures*.

<sup>9</sup>Pursuant to Rule 28(2) of the *Working Procedures*.

Japan appeals from the Panel's findings and conclusions, as well as from certain of the legal interpretations developed by the Panel. Japan argues that the Panel erred in its interpretation of Article III:2, first and second sentences of the General Agreement on Tariffs and Trade 1994 (the "GATT 1994"), which is an integral part of the *Marrakesh Agreement Establishing the World Trade Organization* (the "*WTO Agreement*").<sup>10</sup> According to Japan, with respect to both the first and second sentences of Article III:2, the Panel erred in: (1) disregarding the need to determine whether the Liquor Tax Law has the aim of affording protection to domestic production; (2) ignoring whether there is "linkage" between the origin of products and the tax treatment they incur and, in this respect, not comparing the tax treatment of domestic products as a whole and foreign products as a whole; and (3) not giving proper weight to the tax/price ratio as a yardstick to compare the tax burdens.

With respect to the first sentence of Article III:2, Japan argues that the Panel erred by virtually ignoring Article III:1, particularly the phrase "so as to afford protection to domestic production", as part of the context of Article III:2. Japan maintains also that the title of Article III forms part of the context of Article III:2, and that the object and purpose of the GATT 1994 and the *WTO Agreement* as a whole must also be taken into account in interpreting Article III:2. Japan argues that the interpretation of Article III:2, first sentence, in the light of these considerations, requires an examination of both the aim and the effect of the measure in question. Japan also alleges that the Panel erred in placing excessive emphasis on tariff classification in finding that shochu and vodka are "like products" within the meaning of Article III:2, first sentence, arguing that the relevant tariff bindings indicate that these products are not "like".

With respect to the second sentence of Article III:2, Japan asserts that the Panel erred by failing to interpret correctly the principle of Article III:1, in particular, the language "so as to afford protection to domestic production", erroneously placing excessive emphasis on the phrase "not similarly taxed" in the Interpretative Note *Ad Article III:2*. Japan claims further that the Panel erred by failing to examine the issue of *de minimis* differences in the light of the principle of "so as to afford protection to domestic production"; the Panel examined the issue of *de minimis* differences only by comparing taxes in terms of taxation per kilolitre of product and taxation per degree of alcohol.

With respect to the points of appeal raised by the United States in its appellant's submission, Japan responds that the arguments advanced by the United States are not based on a correct understanding of the Japanese liquor tax system. Japan argues that the Liquor Tax Law has the legitimate policy purpose of ensuring neutrality and equity, particularly horizontal equity, and that it has neither the aim nor the effect of protecting domestic production. Japan asserts that it is not correct

<sup>10</sup>Done at Marrakesh, Morocco, 15 April 1994 and entered into effect on 1 January 1995.

to conclude that all distilled liquors are "like products" under Article III:2, first sentence, or to conclude that the Liquor Tax Law is inconsistent with Article III:2 because it imposes a tax on imported distilled liquors in excess of the tax on like domestic products.

2. United States

The United States supports the Panel's overall conclusions, but appeals nonetheless. The United States alleges several errors in the findings of the Panel and the legal interpretations developed by the Panel in reaching its conclusions in the Panel Report. The United States maintains that the Panel erred in its interpretation of Article III:2, first and second sentences, principally as a result of an erroneous understanding of the relationship between Article III:2 and Article III:1. The United States contends that the Panel disregarded Article III:1, which the United States sees as an integral part of the context that must be considered in interpreting Article III:2, and Article III generally. The United States asserts that Article III:1 sets out the object and purpose of Article III and must therefore be considered in any interpretation of the text of Article III:2. The United States argues that the Panel did not look beyond the text of Article III:2 in interpreting Article III:2 and thereby fell into error.

More specifically, with respect to the first sentence of Article III:2, the United States submits that the Panel erred in finding that "likeness" can be determined purely on the basis of physical characteristics, consumer uses and tariff classification without considering also the context and purpose of Article III, as set out in Article III:1, and without considering, in particular, whether regulatory distinctions are made, in the language of Article III:1, "so as to afford protection to domestic production". The United States concludes that the Panel erred in its interpretation of Article III:2, first sentence in: failing to interpret Article III:2, first sentence, in the light of Article III:1, consistently with the analysis in *United States - Measures Affecting Alcoholic and Malt Beverages* ("Malt Beverages");<sup>11</sup> not finding that all distilled spirits constitute "like products" under Article III:2, first sentence; and drawing a connection between national treatment obligations and tariff bindings.

With respect to the second sentence of Article III:2 and the *Ad Article* thereto, the United States argues that the Panel erred with respect to the *Ad Article* to the second sentence in its interpretation of the term "directly competitive or substitutable products" by not considering whether a tax distinction is applied "in a manner contrary to the principles set forth in paragraph 1 of [Article III]", that is, "so as to afford protection to domestic production". The United States also claims that the Panel erred by using cross-price elasticity as the "decisive criterion" for whether products are "directly competitive or substitutable".

<sup>11</sup>Panel Report adopted on 19 June 1992, BISD 39S/206.

The United States contends as well that the Panel erred in not addressing the full scope of the products subject to the dispute and that there is inconsistency between the Panel's conclusions in paragraph 7.1(ii) of the Panel Report and in paragraphs 6.32-6.33 of the Panel Report. The United States further submits that the Panel erred in incorrectly assessing the relationship between Article III:2 and Article III:4 by stating that the product coverage of the two provisions is not identical.

Finally, the United States claims that the Panel erred in incorrectly characterizing adopted panel reports as "subsequent practice" within the meaning of Article 31(3)(b) of the *Vienna Convention on the Law of Treaties* (the "*Vienna Convention*").<sup>12</sup> According to the United States, adopted panel reports serve only to clarify, for the purposes of the particular dispute, the application of the rights and obligations of the parties to that dispute to the precise set of circumstances at that time. The *decision* to adopt a panel report constitutes a "decision" within the meaning of paragraph 1(b)(iv) of the language incorporating the GATT 1994 into the *WTO Agreement*, however, the adopted panel report as such does not constitute a "decision" in this sense.

With respect to the claims of error raised in Japan's appellant's submission, the United States responds that: the national treatment provisions in Article III of GATT 1994 can apply to origin-neutral measures; Japan's taxation under the Liquor Tax Law does have the aim and effect of affording protection to domestic production; and the tax/price ratios cited by Japan are not the appropriate basis for evaluating the consistency of taxation under the Liquor Tax Law with Article III:2.

3. European Communities

The European Communities support the Panel's conclusions, and largely agree with the legal interpretations of Article III:2, first and second sentences, employed by the Panel. With respect to Article III:2, first sentence, the European Communities submit that the Panel's reasons for adopting the interpretation in the Panel Report, and thus for rejecting a specific test of "aims and effects", are sound and "in accordance with customary rules of interpretation of public international law", as contemplated by Article 3.2 of the *DSU*.<sup>13</sup> The European Communities contend that the Panel made it clear that the essential criterion for a "like product" determination is similarity of physical

<sup>12</sup>23 May 1969, 1155 U.N.T.S. 331; 8 *International Legal Materials* 679.

<sup>13</sup>Article 3.2 of the *DSU* states in pertinent part:

...The Members recognize that [the dispute settlement system] serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law.

characteristics and that tariff nomenclatures may be relevant for a determination of "likeness" because they constitute an objective classification of products according to their physical characteristics. The European Communities maintain that the Panel's decision to identify only vodka and shochu as "like products" for purposes of Article III:2 cannot be regarded as arbitrary or insufficiently motivated. Although not entirely satisfied with the Panel's conclusions on the range of products found to be "like" under Article III:2, first sentence, the European Communities claim that those conclusions primarily involve the assessment of facts and, therefore, are not reviewable by the Appellate Body, which is limited to the consideration of issues of law under Article 17.6 of the DSU.<sup>14</sup>

With respect to Article III:2, second sentence, the European Communities argue that the Panel did not rule that cross-price elasticity is the decisive criterion for a determination that two products are directly competitive or substitutable, but rather ruled that such elasticity is only one of the criteria to be considered. The European Communities view the Panel's findings on the issue of the tax/price ratios as factual; however, if the Appellate Body nevertheless considers it necessary to rule on this issue, the European Communities argue that tax/price ratios are not the most appropriate yardstick for comparing tax burdens imposed by a system of specific taxes. The European Communities submit further that the Panel was correct in ignoring the linkage between differences in taxation and the origin of products. The European Communities assert that Japan's argument that the Liquor Tax Law is not applied "so as to afford protection to domestic production" of shochu because shochu is also produced in other countries and, therefore, is not an "inherently domestic product" rests on two wrong propositions: first, that "domestic production" of shochu is not "protected" if the same tax treatment is accorded to foreign shochu; and, second, that the mere fact that shochu is produced in third countries is sufficient to conclude that foreign shochu may benefit from the lower tax as much as domestic shochu and, consequently, that protection is not afforded only to domestic production. The European Communities further contend that the United States is incorrect to attribute to the Panel the statement that the product coverage of Article III:2 and Article III:4 is not equivalent.

With respect to the status of adopted panel reports, the European Communities conclude that the Panel's characterization of them as "subsequent practice in a specific case" is intrinsically contradictory, since the essence of subsequent practice is that it consists of a large number of legally relevant events and pronouncements. The European Communities' view is that one adopted panel report "would merely constitute part of a wall of the house that constitutes subsequent practice". The European Communities, therefore, ask the Appellate Body to modify the Panel's legal terminology on

<sup>14</sup> Article 17.6 of the DSU states:

An appeal shall be limited to issues of law covered in the panel report and legal interpretations developed by the panel.

this issue. The European Communities further consider that the *decision* to adopt a panel report constitutes a "decision" within the meaning of paragraph 1(b)(iv) of the language of Annex 1A incorporating the GATT 1994 into the *WTO Agreement*, however an adopted panel report is not itself a "decision" in this sense.

4. Canada

Canada confined its submissions and arguments on appeal to Article III:2, second sentence. Canada supports the Panel's legal interpretations of Article III:2, second sentence, as well as the conclusion of the Panel that the Liquor Tax Law is inconsistent with Article III:2, second sentence. Canada claims that the Panel properly found that the phrase "so as to afford protection" in Article III:1 does not require a consideration of both the aim and effect of a measure to determine whether that measure affords protection to domestic production. Canada argues further that: first, the Panel Report did not create a *per se* test in Article III:2, second sentence, and did not equate the reference to "so as to afford protection to domestic production" with a determination that directly competitive or substitutable products are "not similarly taxed"; second, the Panel had sufficient evidence before it to conclude that differential tax treatment under the Liquor Tax Law favours domestic shochu production; third, the Panel Report considered in detail the issue of the tax/price ratios and assigned them their proper weight in assessing the tax burden on the products in dispute; and, finally, the Panel interpreted the phrase "directly competitive or substitutable" properly and did not identify "cross-price elasticity" as *the* decisive criterion for assessment of whether products are directly competitive or substitutable.

With regard to the status of adopted panel reports, Canada argues that decisions to adopt panel reports under GATT 1947 constitute "decisions" under Article 1(b)(iv) of the GATT 1994.

C. Issues Raised in the Appeal

The appellants, Japan and the United States, have raised the following issues in this appeal:

I. Japan

(a) whether the Panel erred in failing to interpret Article III:2, first and second sentences, in the light of Article III:1;

- (b) whether the Panel erred in rejecting an "aim-and-effect" test in establishing whether the Liquor Tax Law is applied "so as to afford protection to domestic production";
- (c) whether the Panel erred in failing to examine the effect of affording protection to domestic production from the perspective of the linkage between the origin of products and their treatment under the Liquor Tax Law;
- (d) whether the Panel failed to give proper weight to tax/price ratios as a yardstick for comparing tax burdens under Article III:2, first and second sentences;
- (e) whether the Panel erred in interpreting and applying Article III:2, second sentence, by equating the language "not similarly taxed" in *Ad Article III:2*, second sentence, with "so as to afford protection" in Article III:1; and
- (f) whether the Panel erred in placing excessive emphasis on tariff classification as a criterion for determining "like products".

2. United States

- (a) whether the Panel erred in failing to interpret Article III:2, first and second sentences, in the light of Article III:1;
- (b) whether the Panel erred in failing to find that all distilled spirits are "like products";
- (c) whether the Panel erred in drawing a connection between national treatment obligations and tariff bindings;
- (d) whether the Panel erred in interpreting and applying Article III:2, second sentence, by equating the language "not similarly taxed" in *Ad Article III:2*, second sentence, with "so as to afford protection" in Article III:1;
- (e) whether the Panel erred in its conclusions on "directly competitive or substitutable products" by examining cross-price elasticity as "the decisive criterion";

- (f) whether the Panel erred in failing to maintain consistency between the conclusions in paragraph 7.1(ii) of the Panel Report on "directly competitive or substitutable products" and the conclusions in paragraphs 6.32-6.33 of the Panel Report, and whether the Panel erred in failing to address the full scope of products subject of this dispute;

- (g) whether the Panel erred in finding that the coverage of Article III:2 and Article III:4 are not equivalent; and

- (h) whether the Panel erred in its characterization of panel reports adopted by the GATT CONTRACTING PARTIES and the WTO Dispute Settlement Body as "subsequent practice in a specific case by virtue of the decision to adopt them".

D. Treaty Interpretation

Article 3.2 of the *DSU* directs the Appellate Body to clarify the provisions of GATT 1994 and the other "covered agreements" of the *WTO Agreement* "in accordance with customary rules of interpretation of public international law". Following this mandate, in *United States - Standards for Reformulated and Conventional Gasoline*,<sup>15</sup> we stressed the need to achieve such clarification by reference to the fundamental rule of treaty interpretation set out in Article 31(1) of the *Vienna Convention*. We stressed there that this general rule of interpretation "has attained the status of a rule of customary or general international law".<sup>16</sup> There can be no doubt that Article 32 of the *Vienna Convention*, dealing with the role of supplementary means of interpretation, has also attained the same status.<sup>17</sup>

Article 31, as a whole, and Article 32 are each highly pertinent to the present appeal. They provide as follows:

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<sup>15</sup>Adopted 20 May 1996, WT/DS2/9.

<sup>16</sup>*Ibid.*, at p. 17.

<sup>17</sup>See e.g.: Jiménez de Aréchaga, "International Law in the Past Third of a Century" (1978-1) 159 *Recueil des Cours* p.1 at 42; *Territorial Dispute (Libyan Arab Jamahiriya/Chad)*, Judgment, (1994), I.C.J. Reports, p. 6 at 20; *Maritime Delimitation and Territorial Questions between Qatar and Bahrain, Jurisdiction and Admissibility*, Judgment, (1995), I.C.J. Reports, p. 6 at 18; *Interpretation of the Convention of 1919 Concerning Employment of Women during the Night* (1932), P.C.I.J., Series A/B, No. 50, p. 365 at 380; cf. the *Serbian and Brazilian Loans Cases* (1929), P.C.I.J., Series A, Nos. 20-21, p. 5 at 30; *Constitution of the Maritime Safety Committee of the IMCO* (1960), I.C.J. Reports, p. 150 at 161; *Air Transport Services Agreement Arbitration (United States of America v. France)* (1963), *International Law Reports*, 38, p. 182 at 235-43.

ARTICLE 31

*General rule of interpretation*

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

- (a) any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;
- (b) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

3. There shall be taken into account together with the context:

- (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
- (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
- (c) any relevant rules of international law applicable in the relations between the parties.

4. A special meaning shall be given to a term if it is established that the parties so intended.

ARTICLE 32

*Supplementary means of interpretation*

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

- (a) leaves the meaning ambiguous or obscure; or
- (b) leads to a result which is manifestly absurd or unreasonable.

Article 31 of the *Vienna Convention* provides that the words of the treaty form the foundation for the interpretive process: "interpretation must be based above all upon the text of the treaty".<sup>18</sup> The provisions of the treaty are to be given their ordinary meaning in their context.<sup>19</sup> The object and purpose of the treaty are also to be taken into account in determining the meaning of its provisions.<sup>20</sup> A fundamental tenet of treaty interpretation flowing from the general rule of interpretation set out in Article 31 is the principle of effectiveness (*ut res magis valeat quam pereat*).<sup>21</sup> In *United States - Standards for Reformulated and Conventional Gasoline*, we noted that "[o]ne of the corollaries of the 'general rule of interpretation' in the *Vienna Convention* is that interpretation must give meaning and effect to all the terms of the treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility".<sup>22</sup>

**E. Status of Adopted Panel Reports**

In this case, the Panel concluded that,

...panel reports adopted by the GATT CONTRACTING PARTIES and the WTO Dispute Settlement Body constitute subsequent practice in a specific case by virtue of the decision to adopt them. Article 1(b)(iv) of GATT 1994 provides institutional recognition that adopted panel reports constitute subsequent practice. Such reports are an integral part of GATT 1994, since they constitute "other decisions of the CONTRACTING PARTIES to GATT 1947".<sup>23</sup>

<sup>18</sup>*Territorial Dispute (Libyan Arab Jamahiriya/Chad)*, Judgment, (1994) I.C.J. Reports, p. 6 at 20; *Maritime Delimitation and Territorial Questions between Qatar and Bahrain, Jurisdiction and Admissibility, Judgment*, (1995) I.C.J. Reports, p. 6 at 18.

<sup>19</sup>See, e.g., *Competence of the General Assembly for the Admission of a State to the United Nations (Second Admissions Case)* (1950), I.C.J. Reports, p. 4 at 8, in which the International Court of Justice stated: "The Court considers it necessary to say that the first duty of a tribunal which is called upon to interpret and apply the provisions of a treaty, is to endeavour to give effect to them in their natural and ordinary meaning and in the context in which they occur".

<sup>20</sup>That is, the treaty's "object and purpose" is to be referred to in determining the meaning of the "terms of the treaty" and not as an independent basis for interpretation: Harris, *Cases and Materials on International Law* (4th ed., 1991) p. 770; Jiménez de Aréchaga, "International Law in the Past Third of a Century" (1978-1) 159 *Recueil des Cours* p. 1 at 44; Sinclair, *The Vienna Convention and the Law of Treaties* (2nd ed., 1984), p. 130. See e.g. Oppenheim's *International Law* (9th ed., Jennings and Watts, eds., 1992) Vol. 1, p.1273; *Competence of the ILO to Regulate the Personal Work of the Employer* (1926), P.C.I.J., Series B, No. 13, p. 6 at 18; *International Status of South West Africa* (1962), I.C.J. Reports, p. 128 at 336; *Re Competence of Conciliation Commission* (1955), 22 *International Law Reports*, p. 867 at 871.

<sup>21</sup>See also (1966) *Yearbook of the International Law Commission*, Vol. II, p. 219: "When a treaty is open to two interpretations one of which does and the other does not enable the treaty to have appropriate effects, good faith and the objects and purposes of the treaty demand that the former interpretation should be adopted."

<sup>22</sup>*United States - Standards for Reformulated and Conventional Gasoline*, WT/DS2/9, adopted 20 May 1996, p. 23.

<sup>23</sup>Panel Report, para. 6.10.

Article 31(3)(b) of the *Vienna Convention* states that "any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation" is to be "taken into account together with the context" in interpreting the terms of the treaty. Generally, in international law, the essence of subsequent practice in interpreting a treaty has been recognized as a "concordant, common and consistent" sequence of acts or pronouncements which is sufficient to establish a discernable pattern implying the agreement of the parties regarding its interpretation.<sup>24</sup> An isolated act is generally not sufficient to establish subsequent practice;<sup>25</sup> it is a sequence of acts establishing the agreement of the parties that is relevant.<sup>26</sup>

Although GATT 1947<sup>27</sup> panel reports were adopted by decisions of the CONTRACTING PARTIES<sup>28</sup>, a decision to adopt a panel report did not under GATT 1947 constitute agreement by the CONTRACTING PARTIES on the legal reasoning in that panel report. The generally-accepted view under GATT 1947 was that the conclusions and recommendations in an adopted panel report bound the parties to the dispute in that particular case, but subsequent panels did not feel legally bound by the details and reasoning of a previous panel report.<sup>29</sup>

We do not believe that the CONTRACTING PARTIES, in deciding to adopt a panel report, intended that their decision would constitute a definitive interpretation of the relevant provisions of GATT 1947. Nor do we believe that this is contemplated under GATT 1994. There is specific cause for this conclusion in the *WTO Agreement*. Article IX:2 of the *WTO Agreement* provides: "The Ministerial Conference and the General Council shall have the exclusive authority to adopt interpretations of this Agreement and of the Multilateral Trade Agreements". Article IX:2 provides further that such decisions "shall be taken by a three-fourths majority of the Members". The fact that such an "exclusive authority" in interpreting the treaty has been established so specifically in the *WTO Agreement* is reason enough to conclude that such authority does not exist by implication or by inadvertence elsewhere.

<sup>24</sup>Sinclair, *The Vienna Convention on the Law of Treaties* (2nd ed., 1984), p. 137; Yasseen, "L'interprétation des traités d'après la Convention de Vienne sur le Droit des Traités" (1976-II) 151 *Recueil des Cours* p. 1 at 48.

<sup>25</sup>Sinclair, *supra.*, footnote 24, p. 137.

<sup>26</sup>(1966) Yearbook of the International Law Commission, Vol. II, p. 222; Sinclair, *supra.*, footnote 24, p. 138.

<sup>27</sup>By GATT 1947, we refer throughout to the General Agreement on Tariffs and Trade, dated 30 October 1947, annexed to the Final Act Adopted at the Conclusion of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment, as subsequently rectified, amended or modified.

<sup>28</sup>By CONTRACTING PARTIES, we refer throughout to the CONTRACTING PARTIES of GATT 1947.

<sup>29</sup>*European Economic Community - Restrictions on Imports of Dessert Apples*, BISD 36S/93, para. 12.1.

Historically, the decisions to adopt panel reports under Article XXIII of the GATT 1947 were different from joint action by the CONTRACTING PARTIES under Article XXV of the GATT 1947. Today, their nature continues to differ from interpretations of the GATT 1994 and the other Multilateral Trade Agreements under the *WTO Agreement* by the WTO Ministerial Conference or the General Council. This is clear from a reading of Article 3.9 of the *DSU*, which states:

The provisions of this Understanding are without prejudice to the rights of Members to seek authoritative interpretation of provisions of a covered agreement through decision-making under the *WTO Agreement* or a covered agreement which is a Plurilateral Trade Agreement.

Article XVI:1 of the *WTO Agreement* and paragraph 1(b)(iv) of the language of Annex 1A incorporating the GATT 1994 into the *WTO Agreement* bring the legal history and experience under the GATT 1947 into the new realm of the WTO in a way that ensures continuity and consistency in a smooth transition from the GATT 1947 system. This affirms the importance to the Members of the WTO of the experience acquired by the CONTRACTING PARTIES to the GATT 1947 -- and acknowledges the continuing relevance of that experience to the new trading system served by the WTO. Adopted panel reports are an important part of the GATT *acquis*. They are often considered by subsequent panels. They create legitimate expectations among WTO Members, and, therefore, should be taken into account where they are relevant to any dispute. However, they are not binding, except with respect to resolving the particular dispute between the parties to that dispute.<sup>30</sup> In short, their character and their legal status have not been changed by the coming into force of the *WTO Agreement*.

For these reasons, we do not agree with the Panel's conclusion in paragraph 6.10 of the Panel Report that "panel reports adopted by the GATT CONTRACTING PARTIES and the WTO Dispute Settlement Body constitute subsequent practice in a specific case" as the phrase "subsequent practice" is used in Article 31 of the *Vienna Convention*. Further, we do not agree with the Panel's conclusion in the same paragraph of the Panel Report that adopted panel reports in themselves constitute "other decisions of the CONTRACTING PARTIES to GATT 1947" for the purposes of paragraph 1(b)(iv) of the language of Annex 1A incorporating the GATT 1994 into the *WTO Agreement*.

<sup>30</sup>It is worth noting that the Statute of the International Court of Justice has an explicit provision, Article 59, to the same effect. This has not inhibited the development by that Court (and its predecessor) of a body of case law in which considerable reliance on the value of previous decisions is readily discernible.

However, we agree with the Panel's conclusion in that same paragraph of the Panel Report that *unadopted* panel reports "have no legal status in the GATT or WTO system since they have not been endorsed through decisions by the CONTRACTING PARTIES to GATT or WTO Members".<sup>31</sup> Likewise, we agree that "a panel could nevertheless find useful guidance in the reasoning of an unadopted panel report that it considered to be relevant".<sup>32</sup>

#### F. Interpretation of Article III

The *WTO Agreement* is a treaty – the international equivalent of a contract. It is self-evident that in an exercise of their sovereignty, and in pursuit of their own respective national interests, the Members of the WTO have made a bargain. In exchange for the benefits they expect to derive as Members of the WTO, they have agreed to exercise their sovereignty according to the commitments they have made in the *WTO Agreement*.

One of those commitments is Article III of the GATT 1994, which is entitled "National Treatment on Internal Taxation and Regulation". For the purpose of this appeal, the relevant parts of Article III read as follows:

#### Article III

##### *National Treatment on Internal Taxation and Regulation*

1. 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.\*
2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no 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.\*

<sup>31</sup>Panel Report, para. 6.10.

<sup>32</sup>*Ibid.*

#### *Ad Article III*

##### *Paragraph 2*

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.

The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. More specifically, the purpose of Article III "is to ensure that internal measures 'not be applied to imported or domestic products so as to afford protection to domestic production'".<sup>33</sup> Toward this end, Article III obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products.<sup>34</sup> "[T]he intention of the drafters of the Agreement was clearly to treat the imported products in the same way as the like domestic products once they had been cleared through customs. Otherwise indirect protection could be given".<sup>35</sup> Moreover, it is irrelevant that "the trade effects" of the tax differential between imported and domestic products, as reflected in the volumes of imports, are insignificant or even non-existent; Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products.<sup>36</sup> Members of the WTO are free to pursue their own domestic goals through internal taxation or regulation so long as they do not do so in a way that violates Article III or any of the other commitments they have made in the *WTO Agreement*.

The broad purpose of Article III of avoiding protectionism must be remembered when considering the relationship between Article III and other provisions of the *WTO Agreement*. Although the protection of negotiated tariff concessions is certainly one purpose of Article III,<sup>37</sup> the statement in Paragraph 6.13 of the Panel Report that "one of the main purposes of Article III is to guarantee that WTO Members will not undermine through internal measures their commitments under Article II" should not be overemphasized. The sheltering scope of Article III is not limited to products that are

<sup>33</sup>*United States - Section 337 of the Tariff Act of 1930*, BISD 36S/345, para. 5.10.

<sup>34</sup>*United States - Taxes on Petroleum and Certain Imported Substances*, BISD 34S/136, para. 5.1.9; *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.5(b).

<sup>35</sup>*Italian Discrimination Against Imported Agricultural Machinery*, BISD 7S/60, para. 11.

<sup>36</sup>*United States - Taxes on Petroleum and Certain Imported Substances*, BISD 34S/136, para. 5.1.9.

<sup>37</sup>*Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.5(b); *Canada - Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*, BISD 39S/27, para. 5.30.

the subject of tariff concessions under Article II. The Article III national treatment obligation is a general prohibition on the use of internal taxes and other internal regulatory measures so as to afford protection to domestic production. This obligation clearly extends also to products not bound under Article II.<sup>38</sup> This is confirmed by the negotiating history of Article III.<sup>39</sup>

#### G. Article III:1

The terms of Article III must be given their ordinary meaning -- in their context and in the light of the overall object and purpose of the *WTO Agreement*. Thus, the words actually used in the Article provide the basis for an interpretation that must give meaning and effect to all its terms. The proper interpretation of the Article is, first of all, a textual interpretation. Consequently, the Panel is correct in seeing a distinction between Article III:1, which "contains general principles", and Article III:2, which "provides for specific obligations regarding internal taxes and internal charges".<sup>40</sup>

<sup>38</sup>*Brazilian Internal Taxes*, BISD II/181, para. 4; *United States - Taxes on Petroleum and Certain Imported Substances*, BISD 34S/136, para. 5.1.9; *EEC - Regulation on Imports of Parts and Components*, BISD 37S/132, para. 5.4.

<sup>39</sup>At the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment, held in 1947, delegates in the Tariff Agreement Committee addressed the issue of whether to include the national treatment clause from the draft Charter for an International Trade Organization ("ITO Charter") in the GATT 1947. One delegate noted:

This Article in the Charter had two purposes, as I understand it. The first purpose was to protect the items in the Schedule or any other Schedule concluded as a result of any subsequent negotiations and agreements - that is, to ensure that a country offering a tariff concession could not nullify that tariff concession by imposing an internal tax on the commodity, which had an equivalent effect. If that were the sole purpose and content of this Article, there could really be no objection to its inclusion in the General Agreement. But the Article in the Charter had an additional purpose. That purpose was to prevent the use of internal taxes as a system of protection. It was part of a series of Articles designed to concentrate national protective measures into the forms permitted under the Charter, i.e. subsidies and tariffs, and since we have taken over this Article from the Charter, we are, by including the Article, doing two things: so far as the countries become parties to the Agreement, we are, first of all, ensuring that the tariff concessions they grant one another cannot be nullified by the imposition of corresponding internal taxes; but we are also ensuring that those countries which become parties to the Agreement undertake not to use internal taxes as a system of protection.

This view is reinforced by the following statement of another delegate:

... [Article III] is necessary to protect not only scheduled items in the Agreement, but, indeed, all items for all our exports and the exports of any country. If that is not done, then every item which does not appear in the Schedule would have to be reconsidered and possibly tariff negotiations re-opened if Article III were changed to permit any action on these non-scheduled items.

See EPCT/TAC/PV.10, pp. 3 and 33.

<sup>40</sup>Panel Report, para. 6.12.

Article III:1 articulates a general principle that internal measures should not be applied so as to afford protection to domestic production. This general principle informs the rest of Article III. The purpose of Article III:1 is to establish this general principle as a guide to understanding and interpreting the specific obligations contained in Article III:2 and in the other paragraphs of Article III, while respecting, and not diminishing in any way, the meaning of the words actually used in the texts of those other paragraphs. In short, Article III:1 constitutes part of the context of Article III:2, in the same way that it constitutes part of the context of each of the other paragraphs in Article III. Any other reading of Article III would have the effect of rendering the words of Article III:1 meaningless, thereby violating the fundamental principle of effectiveness in treaty interpretation. Consistent with this principle of effectiveness, and with the textual differences in the two sentences, we believe that Article III:1 informs the first sentence and the second sentence of Article III:2 in different ways.

#### H. Article III:2

##### 1. First Sentence

Article III:1 informs Article III:2, first sentence, by establishing that if imported products are taxed in excess of like domestic products, then that tax measure is inconsistent with Article III. Article III:2, first sentence does not refer specifically to Article III:1. There is no specific invocation in this first sentence of the general principle in Article III:1 that admonishes Members of the WTO not to apply measures "so as to afford protection". This omission must have some meaning. We believe the meaning is simply that the presence of a protective application need not be established separately from the specific requirements that are included in the first sentence in order to show that a tax measure is inconsistent with the general principle set out in the first sentence. However, this does not mean that the general principle of Article III:1 does not apply to this sentence. To the contrary, we believe the first sentence of Article III:2 is, in effect, an application of this general principle. The ordinary meaning of the words of Article III:2, first sentence leads inevitably to this conclusion. Read in their context and in the light of the overall object and purpose of the *WTO Agreement*, the words of the first sentence require an examination of the conformity of an internal tax measure with Article III by determining, first, whether the taxed imported and domestic products are "like" and, second, whether

the taxes applied to the imported products are "in excess of" those applied to the like domestic products. If the imported and domestic products are "like products", and if the taxes applied to the imported products are "in excess of" those applied to the like domestic products, then the measure is inconsistent with Article III:2, first sentence.<sup>41</sup>

This approach to an examination of Article III:2, first sentence, is consistent with past practice under the GATT 1947.<sup>42</sup> Moreover, it is consistent with the object and purpose of Article III:2, which the panel in the predecessor to this case dealing with an earlier version of the Liquor Tax Law, *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages ("1987 Japan - Alcohol")*, rightly stated as "promoting non-discriminatory competition among imported and like domestic products [which] could not be achieved if Article III:2 were construed in a manner allowing discriminatory and protective internal taxation of imported products in excess of like domestic products".<sup>43</sup>

(a) "Like Products"

Because the second sentence of Article III:2 provides for a separate and distinctive consideration of the protective aspect of a measure in examining its application to a broader category of products that are not "like products" as contemplated by the first sentence, we agree with the Panel that the first sentence of Article III:2 must be construed narrowly so as not to condemn measures that its strict terms are not meant to condemn. Consequently, we agree with the Panel also that the definition of "like products" in Article III:2, first sentence, should be construed narrowly.<sup>44</sup>

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<sup>42</sup>See *Brazilian Internal Taxes*, BISD IV/181, para. 14; *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.5(d); *United States - Taxes on Petroleum and Certain Imported Substances*, BISD 34S/136, para. 5.1.1; *United States - Measures Affecting the Importation, Internal Sale and Use of Tobacco*, DS44/R, adopted on 4 October 1994.

<sup>43</sup>*Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.5(c).

<sup>44</sup>We note the argument on appeal that the Panel suggested in paragraph 6.20 of the Panel Report that the product coverage of Article III:2 is not identical to the coverage of Article III:4. That is not what the Panel said. The Panel said the following:

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<sup>41</sup>In accordance with Article 3.8 of the DSU, such a violation is *prima facie* presumed to nullify or impair benefits under Article XXIII of the GATT 1994. Article 3.8 reads as follows:

In cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of nullification or impairment. This means that there is normally a presumption that a breach of the rules has an adverse impact on other Members parties to that covered agreement, and in such cases, it shall be up to the Member against whom the complaint has been brought to rebut the charge.

How narrowly is a matter that should be determined separately for each tax measure in each case. We agree with the practice under the GATT 1947 of determining whether imported and domestic products are "like" on a case-by-case basis. The Report of the Working Party on *Border Tax Adjustments*, adopted by the CONTRACTING PARTIES in 1970, set out the basic approach for interpreting "like or similar products" generally in the various provisions of the GATT 1947:

... the interpretation of the term should be examined on a case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a "similar" product. Some criteria were suggested for determining, on a case-by-case basis, whether a product is "similar": the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality.<sup>45</sup>

This approach was followed in almost all adopted panel reports after *Border Tax Adjustments*.<sup>46</sup> This approach should be helpful in identifying on a case-by-case basis the range of "like products" that fall within the narrow limits of Article III:2, first sentence in the GATT 1994. Yet this approach will be most helpful if decision makers keep ever in mind how narrow the range of "like products" in Article III:2, first sentence is meant to be as opposed to the range of "like" products contemplated in some other provisions of the GATT 1994 and other Multilateral Trade Agreements of the *WTO Agreement*. In applying the criteria cited in *Border Tax Adjustments* to the facts of any particular case, and in considering other criteria that may also be relevant in certain cases, panels can only apply their best judgement in determining whether in fact products are "like". This will always involve an unavoidable element of individual, discretionary judgement. We do not agree with the Panel's observation in paragraph 6.22 of the Panel Report that distinguishing between "like products" and "directly competitive or substitutable products" under Article III:2 is "an arbitrary decision". Rather, we think it is a discretionary decision that must be made in considering the various characteristics of products in individual cases.

No one approach to exercising judgement will be appropriate for all cases. The criteria in *Border Tax Adjustments* should be examined, but there can be no one precise and absolute definition of what is "like". The concept of "likeness" is a relative one that evokes the image of an accord. The accord of "likeness" stretches and squeezes in different places as different provisions of the *WTO*

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If the coverage of Article III:2 is identical to that of Article III:4, a different interpretation of the term "like product" would be called for in the two paragraphs. Otherwise, if the term "like product" were to be interpreted in an identical way in both instances, the scope of the two paragraphs would be different. (emphasis added)

This was merely a hypothetical statement.

<sup>45</sup>Report of the Working Party on *Border Tax Adjustments*, BISD 18S/97, para. 18.

<sup>46</sup>*The Australian Subsidy on Ammonium Sulphate*, BISD IV/188; *EEC - Measures on Animal Feed Proteins*, BISD 25S/49; *Spain - Tariff Treatment of Unroasted Coffee*, BISD 28S/102; *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83; *United States - Taxes on Petroleum and Certain Imported Substances*, BISD 34S/136. Also see *United States - Standards for Reformulated and Conventional Gasoline*, WT/DS2/9, adopted on 20 May 1996.

Agreement are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term "like" is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply. We believe that, in Article III:2, first sentence of the GATT 1994, the accordions of "likeness" is meant to be narrowly squeezed.

The Panel determined in this case that shochu and vodka are "like products" for the purposes of Article III:2, first sentence. We note that the determination of whether vodka is a "like product" to shochu under Article III:2, first sentence, or a "directly competitive or substitutable product" to shochu under Article III:2, second sentence, does not materially affect the outcome of this case.

A uniform tariff classification of products can be relevant in determining what are "like products". If sufficiently detailed, tariff classification can be a helpful sign of product similarity. Tariff classification has been used as a criterion for determining "like products" in several previous adopted panel reports.<sup>47</sup> For example, in the 1987 *Japan - Alcohol* Panel Report, the panel examined certain wines and alcoholic

beverages on a "product-by-product basis" by applying the criteria listed in the Working Party Report on *Border Tax Adjustments*,

... as well as others recognized in previous GATT practice (see BISD 25S/49, 63), such as the Customs Cooperation Council Nomenclature (CCCN) for the classification of goods in customs tariffs which has been accepted by Japan.<sup>48</sup>

Uniform classification in tariff nomenclatures based on the Harmonized System (the "HS") was recognized in GATT 1947 practice as providing a useful basis for confirming "likeness" in products. However, there is a major difference between tariff classification nomenclature and tariff bindings or concessions made by Members of the WTO under Article II of the GATT 1994. There are risks in using tariff bindings that are too broad as a measure of product "likeness". Many of the least-developed country Members of the WTO submitted schedules of concessions and commitments as annexes to the GATT 1994 for the first time as required by Article XI of the *WTO Agreement*. Many of these least-developed countries, as well as other developing countries, have bindings in their schedules which include broad ranges of products that cut across several different HS tariff headings. For example, many of these countries have very broad uniform bindings on non-agricultural products.<sup>49</sup> This does not necessarily indicate similarity of the products covered by a binding. Rather, it represents the results of trade concessions negotiated among Members of the WTO.

It is true that there are numerous tariff bindings which are in fact extremely precise with regard to product description and which, therefore, can provide significant guidance as to the identification of "like products". Clearly enough, these determinations need to be made on a case-by-case basis. However, tariff bindings that include a wide range of products are not a reliable criterion for determining or confirming product "likeness" under Article III:2.<sup>50</sup>

With these modifications to the legal reasoning in the Panel Report, we affirm the legal conclusions and the findings of the Panel with respect to "like products" in all other respects.

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<sup>48</sup> *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.6.

<sup>49</sup> For example, Jamaica has bound tariffs on the majority of non-agricultural products at 50%. Trinidad and Tobago have bound tariffs on the majority of products falling within HS Chapters 25-97 at 50%. Peru has bound all non-agricultural products at 30%, and Costa Rica, El Salvador, Guatemala, Morocco, Paraguay, Uruguay and Venezuela have broad uniform bindings on non-agricultural products, with a few listed exceptions.

<sup>50</sup> We believe, therefore, that statements relating to any relationship between tariff bindings and "likeness" must be made cautiously. For example, the Panel stated in paragraph 6.21 of the Panel Report that "... with respect to two products subject to the same tariff binding and therefore to the same maximum border tax, there is no justification, outside of those mentioned in GATT rules, to tax them in a differentiated way through internal taxation". This is incorrect.

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<sup>47</sup> *EEC - Measures on Animal Feed Proteins*, BISD 25S/49; *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83; *United States - Standards for Reformulated and Conventional Gasoline*, WT/DS2/9, adopted on 20 May 1996.

(b) *"In Excess Of"*

The only remaining issue under Article III:2, first sentence, is whether the taxes on imported products are "in excess of" those on like domestic products. If so, then the Member that has imposed the tax is not in compliance with Article III. Even the smallest amount of "excess" is too much. "The prohibition of discriminatory taxes in Article III:2, first sentence, is not conditional on a 'trade effects test' nor is it qualified by a *de minimis* standard."<sup>51</sup> We agree with the Panel's legal reasoning and with its conclusions on this aspect of the interpretation and application of Article III:2, first sentence.

2. Second Sentence

Article III:1 informs Article III:2, second sentence, through specific reference. Article III:2, second sentence, contains a general prohibition against "internal taxes or other internal charges" applied to "imported or domestic products in a manner contrary to the principles set forth in paragraph 1". As mentioned before, Article III:1 states that internal taxes and other internal charges "should not be applied to imported or domestic products so as to afford protection to domestic production". Again, *Ad Article III:2* states as follows:

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.

Article III:2, second sentence, and the accompanying *Ad Article* have equivalent legal status in that both are treaty language which was negotiated and agreed at the same time.<sup>52</sup> The *Ad Article* does not replace or modify the language contained in Article III:2, second sentence, but, in fact, clarifies its meaning. Accordingly, the language of the second sentence and the *Ad Article* must be read together in order to give them their proper meaning.

Unlike that of Article III:2, first sentence, the language of Article III:2, second sentence, specifically invokes Article III:1. The significance of this distinction lies in the fact that whereas Article III:1 acts implicitly in addressing the two issues that must be considered in applying the first sentence, it acts explicitly as an entirely separate issue that must be addressed along with two other issues that are raised in applying the second sentence. Giving full meaning to the text and to its context, three separate issues must be addressed to determine whether an internal tax measure is inconsistent with Article III:2, second sentence. These three issues are whether:

- (1) the imported products and the domestic products are "*directly competitive or substitutable products*" which are in competition with each other;
- (2) the directly competitive or substitutable imported and domestic products are "*not similarly taxed*"; and
- (3) the dissimilar taxation of the directly competitive or substitutable imported domestic products is "*applied ... so as to afford protection to domestic production*".

Again, these are three separate issues. Each must be established separately by the complainant for a panel to find that a tax measure imposed by a Member of the WTO is inconsistent with Article III:2, second sentence.

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<sup>52</sup>The negotiating history of Article III:2 confirms that the second sentence and the *Ad Article* were added during the Havana Conference, along with other provisions and interpretative notes concerning Article 18 of the draft ITO Charter. When introducing these amendments to delegates, the relevant Sub-Committee reported that: "The new form of the Article makes clearer than did the Geneva text the intention that internal taxes on goods should not be used as a means of protection. The details have been relegated to interpretative notes so that it would be easier for Members to ascertain the precise scope of their obligations under the Article." E/CONF.2/C.3/59, page 8. Article 18 of the draft ITO Charter subsequently became Article III of the GATT pursuant to the Protocol Modifying Part II and Article XXVI, which entered into force on 14 December 1948.

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<sup>51</sup>*United States - Measures Affecting Alcoholic and Malt Beverages*, BISD 39S/206, para 5.6; see also *Brazilian Internal Taxes*, BISD II/181, para. 16; *United States - Taxes on Petroleum and Certain Imported Substances*, BISD 34S/136, para. 5.1.9; *Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.8.

(a) "Directly Competitive or Substitutable Products"

If imported and domestic products are not "like products" for the narrow purposes of Article III:2, first sentence, then they are not subject to the strictures of that sentence and there is no inconsistency with the requirements of that sentence. However, depending on their nature, and depending on the competitive conditions in the relevant market, those same products may well be among the broader category of "directly competitive or substitutable products" that fall within the domain of Article III:2, second sentence. How much broader that category of "directly competitive or substitutable products" may be in any given case is a matter for the panel to determine based on all the relevant facts in that case. As with "like products" under the first sentence, the determination of the appropriate range of "directly competitive or substitutable products" under the second sentence must be made on a case-by-case basis.

In this case, the Panel emphasized the need to look not only at such matters as physical characteristics, common end-uses, and tariff classifications, but also at the "market place".<sup>53</sup> This seems appropriate. The GATT 1994 is a commercial agreement, and the WTO is concerned, after all, with markets. It does not seem inappropriate to look at competition in the relevant markets as one among a number of means of identifying the broader category of products that might be described as "directly competitive or substitutable".

Nor does it seem inappropriate to examine elasticity of substitution as one means of examining those relevant markets. The Panel did not say that cross-price elasticity of demand is "the decisive criterion"<sup>54</sup> for determining whether products are "directly competitive or substitutable". The Panel stated the following:

In the Panel's view, the decisive criterion in order to determine whether two products are directly competitive or substitutable is whether they have common end-uses, *inter alia*, as shown by elasticity of substitution.<sup>55</sup>

We agree. And, we find the Panel's legal analysis of whether the products are "directly competitive or substitutable products" in paragraphs 6.28-6.32 of the Panel Report to be correct.

We note that the Panel's conclusions on "like products" and on "directly competitive or substitutable products" contained in paragraphs 7.1(i) and (ii), respectively, of the Panel Report fail to

<sup>53</sup>Panel Report, para. 6.22.

<sup>54</sup>United States Appellant's Submission, dated 23 August 1996, para. 98, p.63. (emphasis added)

<sup>55</sup>Panel Report, para 6.22.

address the full range of alcoholic beverages included in the Panel's Terms of Reference.<sup>56</sup> More specifically, the Panel's conclusions in paragraph 7.1(ii) on "directly competitive or substitutable products" relate only to "shochu, whisky, brandy, rum, gin, genever, and liqueurs," which is narrower than the range of products referred to the Dispute Settlement Body by one of the complainants, the United States, which included in its request for the establishment of a panel "all other distilled spirits and liqueurs falling within HS heading 2208". We consider this failure to incorporate into its conclusions all the products referred to in the Terms of Reference, consistent with the matters referred to the DSB in WT/DS8/5, WT/DS10/5 and WT/DS11/2, to be an error of law by the Panel.

(b) "Not Similarly Taxed"

To give due meaning to the distinctions in the wording of Article III:2, first sentence, and Article III:2, second sentence, the phrase "not similarly taxed" in the *Ad Article* to the second sentence must not be construed so as to mean the same thing as the phrase "in excess of" in the first sentence. On its face, the phrase "in excess of" in the first sentence means *any* amount of tax on imported products "in excess of" the tax on domestic "like products". The phrase "not similarly taxed" in the *Ad Article* to the second sentence must therefore mean something else. It requires a different standard, just as "directly competitive or substitutable products" requires a different standard as compared to "like products" for these same interpretive purposes.

Reinforcing this conclusion is the need to give due meaning to the distinction between "like products" in the first sentence and "directly competitive or substitutable products" in the *Ad Article* to the second sentence. If "in excess of" in the first sentence and "not similarly taxed" in the *Ad Article* to the second sentence were construed to mean one and the same thing, then "like products" in the first sentence and "directly competitive or substitutable products" in the *Ad Article* to the second sentence would also mean one and the same thing. This would eviscerate the distinctive meaning that must be respected in the words of the text.

To interpret "in excess of" and "not similarly taxed" identically would deny any distinction between the first and second sentences of Article III:2. Thus, in any given case, there may be some amount of taxation on imported products that may well be "in excess of" the tax on domestic "like

<sup>56</sup>The Panel's Terms of Reference cite the matters referred to the Dispute Settlement Body by the European Communities, Canada and the United States in WT/DS8/5, WT/DS10/5 and WT/DS11/2, respectively. In WT/DS8/5, the European Communities referred the Dispute Settlement Body to Japan's taxation of shochu, "spirits", "whisky/brandy" and "liqueurs". In WT/DS10/5, Canada referred the Dispute Settlement Body to Japan's taxation of shochu and products falling "within HS 2208.30 ('whiskies'), HS 2208.40 ('rum and tafia'), HS 2208.90 ('other' including fruit brandies, vodka, ouzo, korn, cream liqueurs and 'classic' liqueurs.)" In WT/DS11/2, the United States referred the Dispute Settlement Body to Japan's taxation of shochu and "all other distilled spirits and liqueurs falling within HS heading 2208".

products" but may not be so much as to compel a conclusion that "directly competitive or substitutable" imported and domestic products are "not similarly taxed" for the purposes of the *Ad* Article to Article III:2, second sentence. In other words, there may be an amount of excess taxation that may well be more of a burden on imported products than on domestic "directly competitive or substitutable products" but may nevertheless not be enough to justify a conclusion that such products are "not similarly taxed" for the purposes of Article III:2, second sentence. We agree with the Panel that this amount of differential taxation must be more than *de minimis* to be deemed "not similarly taxed" in any given case.<sup>57</sup> And, like the Panel, we believe that whether any particular differential amount of taxation is *de minimis* or is not *de minimis* must, here too, be determined on a case-by-case basis. Thus, to be "not similarly taxed", the tax burden on imported products must be heavier than on "directly competitive or substitutable" domestic products, and that burden must be more than *de minimis* in any given case.

In this case, the Panel applied the correct legal reasoning in determining whether "directly competitive or substitutable" imported and domestic products were "not similarly taxed". However, the Panel erred in blurring the distinction between that issue and the entirely separate issue of whether the tax measure in question was applied "so as to afford protection". Again, these are separate issues that must be addressed individually. If "directly competitive or substitutable products" are *not* "not similarly taxed", then there is neither need nor justification under Article III:2, second sentence, for inquiring further as to whether the tax has been applied "so as to afford protection". But if such products are "not similarly taxed", a further inquiry must necessarily be made.

(c) "*So As To Afford Protection*"

This third inquiry under Article III:2, second sentence, must determine whether "directly competitive or substitutable products" are "not similarly taxed" in a way that affords protection. This is not an issue of intent. It is not necessary for a panel to sort through the many reasons legislators and regulators often have for what they do and weigh the relative significance of those reasons to establish legislative or regulatory intent. If the measure is applied to imported or domestic products so as to afford protection to domestic production, then it does not matter that there may not have been any desire to engage in protectionism in the minds of the legislators or the regulators who imposed the measure. It is irrelevant that protectionism was not an intended objective if the particular tax measure in question is nevertheless, to echo Article III:1, "*applied* to imported or domestic products so as to afford protection to domestic production".<sup>58</sup> This is an issue of how the measure in question is *applied*.

<sup>57</sup>Panel Report, para. 6.33.

<sup>58</sup>Emphasis added.

In the 1987 *Japan- Alcohol* case, the panel subsumed its discussion of the issue of "not similarly taxed" within its examination of the separate issue of "so as to afford protection":

... whereas under the first sentence of Article III:2 the tax on the imported product and the tax on the like domestic product had to be equal in effect, Article III:1 and 2, second sentence, prohibited only the application of internal taxes to imported or domestic products in a manner "so as to afford protection to domestic production". The Panel was of the view that also small tax differences could influence the competitive relationship between directly competing distilled liquors, but the existence of protective taxation could be established only in the light of the particular circumstances of each case and there could be a *de minimis* level below which a tax difference ceased to have the protective effect prohibited by Article III:2, second sentence.<sup>59</sup>

To detect whether the taxation was protective, the panel in the 1987 case examined a number of factors that it concluded were "sufficient evidence of fiscal distortions of the competitive relationship between imported distilled liquors and domestic shochu affording protection to the domestic production of shochu". These factors included the considerably lower specific tax rates on shochu than on imported directly competitive or substitutable products; the imposition of high *ad valorem* taxes on imported alcoholic beverages and the absence of *ad valorem* taxes on shochu; the fact that shochu was almost exclusively produced in Japan and that the lower taxation of shochu did "afford protection to domestic production"; and the mutual substitutability of these distilled liquors.<sup>60</sup> The panel in the 1987 case concluded that "the application of considerably lower internal taxes by Japan on shochu than on other directly competitive or substitutable distilled liquors had trade-distorting effects affording protection to domestic production of shochu contrary to Article III:1 and 2, second sentence".<sup>61</sup>

As in that case, we believe that an examination in any case of whether dissimilar taxation has been applied so as to afford protection requires a comprehensive and objective analysis of the structure and application of the measure in question on domestic as compared to imported products. We believe

<sup>59</sup>*Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.11.

<sup>60</sup>*Ibid.*

<sup>61</sup>*Ibid.*

it is possible to examine objectively the underlying criteria used in a particular tax measure, its structure, and its overall application to ascertain whether it is applied in a way that affords protection to domestic products.

Although it is true that the aim of a measure may not be easily ascertained, nevertheless its protective application can most often be discerned from the design, the architecture, and the revealing structure of a measure. The very magnitude of the dissimilar taxation in a particular case may be evidence of such a protective application, as the Panel rightly concluded in this case. Most often, there will be other factors to be considered as well. In conducting this inquiry, panels should give full consideration to all the relevant facts and all the relevant circumstances in any given case.

In this respect, we note and agree with the panel's acknowledgment in the 1987 *Japan - Alcohol* Report:

... that Article III:2 does not prescribe the use of any specific method or system of taxation. ... there could be objective reasons proper to the tax in question which could justify or necessitate differences in the system of taxation for imported and for domestic products. The Panel found that it could also be compatible with Article III:2 to allow two different methods of calculation of price for tax purposes. Since Article III:2 prohibited only discriminatory or protective tax burdens on imported products, what mattered was, in the view of the Panel, whether the application of the different taxation methods actually had a discriminatory or protective effect against imported products.<sup>62</sup>

We have reviewed the Panel's reasoning in this case as well as its conclusions on the issue of "so as to afford protection" in paragraphs 6.33 - 6.35 of the Panel Report. We find cause for thorough examination. The Panel began in paragraph 6.33 by describing its approach as follows:

... if directly competitive or substitutable products are not "similarly taxed", and if it were found that the tax favours domestic products, then protection would be afforded to such products, and Article III:2, second sentence, is violated.

This statement of the reasoning required under Article III:2, second sentence is correct.

However, the Panel went on to note:

... for it to conclude that dissimilar taxation afforded protection, it would be sufficient for it to find that the dissimilarity in taxation is not *de minimis*. ... the Panel took the view that "similarly taxed" is the appropriate benchmark in order to determine whether a violation of Article III:2, second sentence, has occurred as opposed to "in excess of" that constitutes the appropriate benchmark to determine whether a violation of Article III:2, first sentence, has occurred.<sup>63</sup>

In paragraph 6.34, the Panel added:

(i) The benchmark in Article III:2, second sentence, is whether internal taxes operate "so as to afford protection to domestic production", a term which has been further interpreted in the Interpretative Note ad Article III:2, paragraph 2, to mean dissimilar taxation of domestic and foreign directly competitive or substitutable products.

And, furthermore, in its conclusions, in paragraph 7.1(ii), the Panel concluded that:

(ii) Shochu, whisky, brandy, rum, gin, genever, and liqueurs are "directly competitive or substitutable products" and Japan, by not taxing them similarly, is in violation of its obligation under Article III:2, second sentence, of the General Agreement on Tariffs and Trade 1994.

Thus, having stated the correct legal approach to apply with respect to Article III:2, second sentence, the Panel then equated dissimilar taxation above a *de minimis* level with the separate and distinct requirement of demonstrating that the tax measure "affords protection to domestic production". As previously stated, a finding that "directly competitive or substitutable products" are "not similarly taxed" is necessary to find a violation of Article III:2, second sentence. Yet this is not enough. The dissimilar taxation must be more than *de minimis*. It may be so much more that it will be clear from that very differential that the dissimilar taxation was applied "so as to afford protection". In some cases, that may be enough to show a violation. In this case, the Panel concluded that it was enough. Yet in other cases, there may be other factors that will be just as relevant or more relevant to demonstrating that the dissimilar taxation at issue was applied "so as to afford protection". In any case, the three issues that must be addressed in determining whether there is such a violation must be addressed clearly and separately in each case and on a case-by-case basis. And, in every case, a careful, objective analysis, must be done of each and all relevant facts and all the relevant circumstances in order to determine "the existence of protective taxation".<sup>64</sup> Although the Panel blurred its legal reasoning in this respect, nevertheless we conclude that it reasoned correctly that in this case, the Liquor Tax Law is not in compliance with Article III:2. As the Panel did, we note that:

<sup>62</sup>*Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.9(c).

<sup>63</sup>Panel Report, para 6.33.

<sup>64</sup>*Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.11.

...the combination of customs duties and internal taxation in Japan has the following impact: on the one hand, it makes it difficult for foreign-produced shochu to penetrate the Japanese market and, on the other, it does not guarantee equality of competitive conditions between shochu and the rest of 'white' and 'brown' spirits. Thus, through a combination of high import duties and differentiated internal taxes, Japan manages to "isolate" domestically produced shochu from foreign competition, be it foreign produced shochu or any other of the mentioned white and brown spirits.<sup>65</sup>

Our interpretation of Article III is faithful to the "customary rules of interpretation of public international law".<sup>66</sup> WTO rules are reliable, comprehensible and enforceable. WTO rules are not so rigid or so inflexible as not to leave room for reasoned judgements in confronting the endless and ever-changing ebb and flow of real facts in the real world. They will serve the multilateral trading system best if they are interpreted with that in mind. In that way, we will achieve the "security and predictability" sought for the multilateral trading system by the Members of the WTO through the establishment of the dispute settlement system.<sup>67</sup>

## I. Conclusions and Recommendations

For the reasons set out in the preceding sections of this report, the Appellate Body has reached the following conclusions:

- (a) the Panel erred in law in its conclusion that "panel reports adopted by the GATT CONTRACTING PARTIES and the WTO Dispute Settlement Body constitute subsequent practice in a specific case by virtue of the decision to adopt them";
- (b) the Panel erred in law in failing to take into account Article III:1 in interpreting Article III:2, first and second sentences;
- (c) the Panel erred in law in limiting its conclusions in paragraph 7.1(ii) on "directly competitive or substitutable products" to "shochu, whisky, brandy, rum, gin, genever, and liqueurs", which is not consistent with the Panel's Terms of Reference; and
- (d) the Panel erred in law in failing to examine "so as to afford protection" in Article III:1 as a separate inquiry from "not similarly taxed" in the *Ad Article* to Article III:2, second sentence.

With the modifications to the Panel's legal findings and conclusions set out in this report, the Appellate Body affirms the Panel's conclusions that shochu and vodka are like products and that Japan, by taxing imported products in excess of like domestic products, is in violation of its obligations under Article III:2, first sentence, of the General Agreement on Tariffs and Trade 1994. Moreover, the Appellate Body concludes that shochu and other distilled spirits and liqueurs listed in HS 2208, except for vodka, are "directly competitive or substitutable products", and that Japan, in the application of the Liquor Tax Law, does not similarly tax imported and directly competitive or substitutable domestic products and affords protection to domestic production in violation of Article III:2, second sentence, of the General Agreement on Tariffs and Trade 1994.

The Appellate Body *recommends* that the Dispute Settlement Body request Japan to bring the Liquor Tax Law into conformity with its obligations under the General Agreement on Tariffs and Trade 1994.

<sup>65</sup> Panel Report, para. 6.35.

<sup>66</sup> Article 3.2 of the *DSU*.

<sup>67</sup> *Ibid.*

Signed in the original at Geneva this 25th day of September 1996 by:

\_\_\_\_\_  
Julio Lacarte-Muró  
Presiding Member

\_\_\_\_\_  
James Bacchus  
Member  
Member

Said El-Naggar



**World Trade Organization**

**European Communities – Measures concerning Meat and  
Meat Products (Hormones)**

**Report of the Appellate Body, 16 January 1996**

WORLD TRADE  
ORGANIZATION

WT/DS26/AB/R  
WT/DS48/AB/R  
16 January 1998

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EC MEASURES CONCERNING MEAT AND MEAT PRODUCTS  
(HORMONES)

AB-1997-4

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WORLD TRADE ORGANIZATION  
APPELLATE BODY

EC Measures Concerning Meat and Meat  
Products (Hormones)

European Communities, Appellant/Appellee

United States, Appellant/Appellee  
Canada, Appellant/Appellee

Australia, New Zealand and Norway, Third  
Participants

AB-1997-4

Present:

Feliciano, Presiding Member  
Ehlermann, Member  
Matsushita, Member

set forth in a series of Directives of the Council of Ministers that were enacted before 1 January 1995. Those Directives were:

1. Council Directive 81/602/EEC of 31 July 1981 ("Directive 81/602");<sup>3</sup>
  2. Council Directive 88/146/EEC of 7 March 1988 ("Directive 88/146");<sup>4</sup>; and
  3. Council Directive 88/299/EEC of 17 May 1988 ("Directive 88/299").<sup>5</sup>
3. Directive 81/602 prohibited the administration to farm animals of substances having a hormonal action and of substances having a thyrostatic action. It also prohibited the placing on the European market of both domestically produced and imported meat and meat products derived from farm animals to which such substances had been administered. Two exceptions to this prohibition were provided for. One exception covered substances with an oestrogenic, androgenic or gestagenic action when used for therapeutic or zootechnical purposes and administered by a veterinarian or under a veterinarian's responsibility. The other exception related to three natural hormones (oestradiol - 17 , progesterone and testosterone) and two synthetic hormones (trenbolone acetate and zeranol) used for growth promotion purposes if allowed under the regulations of the Member States of the European Economic Community ("EEC"), until a detailed examination of the effects of these substances could be carried out and until the EEC could take a decision on the use of these substances for growth promotion. The sixth hormone involved in this appeal, MGA, was not included in the second exception; it was covered by the general prohibition concerning substances having a hormonal or thyrostatic action.

4. Seven years later<sup>6</sup>, Directive 88/146 was promulgated prohibiting the administration to farm animals of the synthetic hormones: trenbolone acetate and zeranol, for any purposes, as well as the administration of the natural hormones: oestradiol - 17 , progesterone and testosterone, for growth promotion or fattening purposes. This Directive permitted Member States of the EEC to authorize, under specified conditions, the use of the three natural hormones for therapeutic and zootechnical purposes. Directive 88/146 explicitly prohibited both the intra-EEC trade and the importation from third countries of meat and meat products

<sup>3</sup>Official Journal, No. L 222, 7 August 1981, p. 32.

<sup>4</sup>Official Journal, No. L 70, 16 March 1988, p. 16.

<sup>5</sup>Official Journal, No. L 128, 21 May 1988, p. 36.

<sup>6</sup>It should be noted that on 31 December 1985 the Council of Ministers adopted Directive 85/649/EEC prohibiting the use in livestock farming of certain substances having a hormonal action, Official Journal, No. L 382, 31 December 1985, p. 228. This Directive prohibited the use of all the hormones (except MGA, the use of which had been previously prohibited) for growth promotion purposes and established more detailed provisions concerning authorized therapeutic uses. This Directive was challenged in the Court of Justice of the European Communities, which annulled it on procedural grounds in its Judgment of 23 February 1988, [1988] E.C.R. 855. Shortly afterwards, the European Commission submitted to the Council a proposal for a substantively identical Directive, which the Council adopted on 7 March 1988 as Directive 88/146/EEC.

I. Introduction: Statement of the Appeal

1. The European Communities, the United States and Canada appeal from certain issues of law and legal interpretations in the Panel Reports, EC Measures Concerning Meat and Meat Products (Hormones).<sup>1</sup> These two Panel Reports, circulated to Members of the World Trade Organization ("WTO") on 18 August 1997, were rendered by two Panels composed of the same three persons.<sup>2</sup> These Panel Reports are similar, but they are not identical in every respect. The Panel in the complaint brought by the United States was established by the Dispute Settlement Body (the "DSB") on 20 May 1996. On 16 October 1996, the DSB established the Panel in the complaint brought by Canada. The European Communities and Canada agreed, on 4 November 1996, that the composition of the latter Panel would be identical to the composition of the Panel established at the request of the United States.

2. The Panel dealt with a complaint against the European Communities relating to an EC prohibition of imports of meat and meat products derived from cattle to which either the natural hormones: oestradiol - 17 , progesterone or testosterone, or the synthetic hormones: trenbolone acetate, zeranol or melengestrol acetate ("MGA"), had been administered for growth promotion purposes. This import prohibition was

<sup>1</sup>Complaint by the United States, WT/DS26/R/USA, (the "US Panel Report") and Complaint by Canada, WT/DS48/R/CAN, (the "Canada Panel Report").

<sup>2</sup>As the composition of both Panels was identical, we will refer to the Panels as "the Panel".

obtained from animals to which substances having oestrogenic, androgenic, gestagenic or thyrostatic action had been administered. Trade in meat and meat products derived from animals treated with such substances for therapeutic or zootechnical purposes was allowed only under certain conditions. Those conditions were set out in Directive 88/299.

5. Effective as of 1 July 1997, Directives 81/602, 88/146 and 88/299 were repealed and replaced with Council Directive 96/22/EC of 29 April 1996 ("Directive 96/22").<sup>7</sup> This Directive maintains the prohibition of the administration to farm animals of substances having a hormonal or thyrostatic action. As under the previously applicable Directives, it is prohibited to place on the market, or to import from third countries, meat and meat products from animals to which such substances, including the six hormones at issue in this dispute, were administered. This Directive also continues to allow Member States to authorize the administration, for therapeutic and zootechnical purposes, of certain substances having a hormonal or thyrostatic action. Under certain conditions, Directive 96/22 allows the placing on the market, and the importation from third countries, of meat and meat products from animals to which these substances have been administered for therapeutic and zootechnical purposes.

6. The Panel circulated its Reports to the Members of the WTO on 18 August 1997. The US Panel Report and the Canada Panel Report reached the same conclusions in paragraph 9.1:

- (i) The European Communities, by maintaining sanitary measures which are not based on a risk assessment, has acted inconsistently with the requirements contained in Article 5.1 of the Agreement on the Application of Sanitary and Phytosanitary Measures.
- (ii) The European Communities, by adopting arbitrary or unjustifiable distinctions in the levels of sanitary protection it considers to be appropriate in different situations which result in discrimination or a disguised restriction on international trade, has acted inconsistently with the requirement contained in Article 5.5 of the Agreement on the Application of Sanitary and Phytosanitary Measures.
- (iii) The European Communities, by maintaining sanitary measures which are not based on existing international standards without justification under Article 3.3 of the Agreement on the Application of Sanitary and Phytosanitary Measures, has acted inconsistently with the requirements of Article 3.1 of that Agreement.

In both Reports, the Panel recommended in paragraph 9.2:

... that the Dispute Settlement Body requests the European Communities to bring its measures in dispute into conformity with its obligations under the Agreement on the Application of Sanitary and Phytosanitary Measures.

7. On 24 September 1997, the European Communities notified the DSB of its decision to appeal certain issues of law covered in the Panel Reports and certain legal interpretations developed by the Panel, pursuant to paragraph 4 of Article 16 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (the "DSU"), and filed two notices of appeal<sup>8</sup> with the Appellate Body pursuant to Rule 20 of the Working Procedures for Appellate Review (the "Working Procedures"). Pursuant to Rule 21 of the Working Procedures, the European Communities filed an appellant's submission on 6 October 1997. On 9 October 1997, the United States and Canada filed appellants' submissions pursuant to Rule 23(1) of the Working Procedures. On 20 October 1997, the United States and Canada each filed an appellee's submission pursuant to Rule 22 of the Working Procedures and the European Communities filed its own appellee's submission pursuant to Rule 23(3) of the Working Procedures. On the same day, Australia, New Zealand and Norway filed separate third participants' submissions in accordance with Rule 24 of the Working Procedures.

8. The oral hearing was held on 4 and 5 November 1997. The participants and third participants presented oral arguments and responded to questions put to them by the Members of the Division hearing this appeal. The participants and third participants also gave oral concluding statements.

## II. Arguments of the Participants and Third Participants

### A. Claims of Error by the European Communities - Appellant

#### 1. Burden of Proof

9. The European Communities argues that the Panel erred in its allocation of the burden of proof in this dispute in three respects. In the view of the European Communities, the Panel erred on the issue of burden of proof under the Agreement on the Application of Sanitary and Phytosanitary Measures (the "SPS Agreement") in general; in allocating the burden of proof under Article 3.3 of the SPS Agreement; and in allocating the burden of proof under Article 5.1 of the SPS Agreement.

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<sup>7</sup>Official Journal L No. L 125, 23 May 1996, p. 3.

<sup>8</sup>WT/DS26/9, 25 September 1997, and WT/DS48/7, 25 September 1997.

10. In respect of the issue of burden of proof under the SPS Agreement in general, the European Communities argues that the Panel erred in finding that the burden of proof under the SPS Agreement rests on the Member imposing a measure.<sup>9</sup> According to the European Communities, none of the general considerations invoked by the Panel supports the view that special rules on the burden of proof should be applied in proceedings concerning the SPS Agreement.

11. As to the allocation of the burden of proof under Article 3.3 of the SPS Agreement, the European Communities disagrees with the Panel's finding that Article 3.3 constitutes an exception to the general obligation, contained in Article 3.1, to base measures on international standards, and that the burden of proof under Article 3.3 is therefore on the responding party.<sup>10</sup> The European Communities argues that the SPS Agreement expressly recognizes that a Member has the right to choose an appropriate level of sanitary and phytosanitary protection, and that Article 3.3 lays down specific conditions governing the exercise of that right in those cases where an international standard exists. According to the European Communities, Article 3.1 does not provide a "general obligation" to be read in isolation, but presents one of three options available to a Member when an international standard exists.

12. With regard to the burden of proof under Article 5.1 of the SPS Agreement, the European Communities opposes the Panel's finding that Canada and the United States had met their burden of presenting a prima facie case of inconsistency with Article 5.1, in respect of importation of meat treated with the MGA hormone.<sup>11</sup> The European Communities notes that Canada and the United States stated that they had conducted risk assessments and had authorized MGA for growth promotion, but refused to provide scientific evidence and information, claiming their studies were proprietary and confidential in nature. The European Communities believes that the Panel has fundamentally erred in law by condoning the refusals by Canada and the United States to submit all studies available.

## 2. Standard of Review

13. The European Communities claims that the Panel erred in law<sup>12</sup> by not according deference to the following aspects of the EC measures: first, the decision of the European Communities to set and apply a level of sanitary protection higher than that recommended by the Codex Alimentarius (the "Codex")

<sup>9</sup>US Panel Report, paras. 8.52-8.54; Canada Panel Report, paras. 8.55-8.57.

<sup>10</sup>US Panel Report, para. 8.86; Canada Panel Report, para. 8.89.

<sup>11</sup>US Panel Report, para. 8.253; Canada Panel Report, para. 8.256.

<sup>12</sup>US Panel Report, paras. 8.124, 8.127, 8.133, 8.134, 8.145, 8.146, 8.194, 8.199, 8.213 and 8.255; Canada Panel Report, paras. 8.127, 8.130, 8.136, 8.137, 8.148, 8.149, 8.197, 8.202, 8.216 and 8.258.

for the risks arising from the use for growth promotion of the hormones in dispute; second, the EC's scientific assessment and management of the risk from the hormones at issue, and third, the EC's adherence to the precautionary principle and its aversion to accepting any increased carcinogenic risk.

14. It is submitted by the European Communities that WTO panels should adopt a deferential "reasonableness" standard when reviewing a Member's decision to adopt a particular science policy or a Member's determination that a particular inference from the available data is scientifically plausible. To the European Communities, the Panel in this case imposed its own assessment of the scientific evidence.

15. The European Communities asserts that GATT 1947 panel reports rejected a de novo standard of review in relation to fact-finding<sup>13</sup>, and that this approach has been maintained by panels established under the DSU.<sup>14</sup> It is contended that the "reasonable deference standard of review" has been given expression in the Marrakesh Agreement Establishing the World Trade Organization<sup>15</sup> (the "WTO Agreement") in Article 17.6 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (the "Anti-Dumping Agreement"). The European Communities considers that the principle of reasonable deference is applicable in all highly complex factual situations, including the assessment of the risks to human health arising from toxins and contaminants, and that therefore, the Panel applied an inappropriate standard of review in the present case.

## 3. The Precautionary Principle

16. The European Communities submits that the Panel erred in law in considering that the precautionary principle was only relevant for "provisional measures" under Article 5.7 of the SPS Agreement.<sup>16</sup> The precautionary principle is already, in the view of the European Communities, a general customary rule

<sup>13</sup>The European Communities refers to: Panel Report, United States - Imposition of Anti-Dumping Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway, adopted 27 April 1994, ADP/87; Panel Report, United States - Imposition of Countervailing Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway, adopted 28 April 1994, SCM/153; Panel Report, Korea - Anti-Dumping Duties on Imports of Polyacetal Resins from the United States, adopted 27 April 1993, BISD 40S/205; Panel Report, United States - Measures Affecting Imports of Softwood Lumber from Canada, adopted 27-28 October 1993, BISD 40S/358, Panel Report, United States - Anti-Dumping Duties on Imports of Stainless Steel Plate from Sweden, ADP/117, 24 February 1994, unadopted; Panel Report, EC - Anti-Dumping Duties on Audio Tapes in Cassettes originating in Japan, ADP/136, 28 April 1995, unadopted; and Panel Report, United States - Imposition of Countervailing Duties on Certain Hot-rolled Lead and Bismuth Carbon Steel Products originating in France, Germany and the United Kingdom, SCM/185, 15 November 1994, unadopted.

<sup>14</sup>The European Communities refers to: Panel Report, United States - Restrictions on Imports of Cotton and Man-made Fibre Underwear ("United States - Underwear"), adopted 25 February 1997, WT/DS24/R; Panel Report, United States - Measure Affecting Imports of Woven Wool Shirts and Blouses ("United States - Shirts and Blouses"), adopted 23 May 1997, WT/DS33/R. <sup>15</sup>Done at Marrakesh, Morocco, 15 April 1994.

<sup>16</sup>US Panel Report, paras. 8.157 and 8.158; Canada Panel Report, paras. 8.160 and 8.161.

of international law or at least a general principle of law, the essence of which is that it applies not only in the management of a risk, but also in the assessment thereof. It is claimed that the Panel therefore erred in stating that the application of the precautionary principle "would not override the explicit wording in Articles 5.1 and 5.2 [of the SPS Agreement]", and in suggesting that that principle might be in conflict with those Articles. The European Communities asserts that Articles 5.1 and 5.2 and Annex A.4 of the SPS Agreement do not prescribe a particular type of risk assessment, but rather simply identify factors that need to be taken into account. Thus, these provisions do not prevent Members from being cautious when setting health standards in the face of conflicting scientific information and uncertainty.

#### 4. Objective Assessment of the Facts

17. The European Communities argues that the Panel failed to make an objective assessment of the facts and therefore did not comply with its obligations under Article 11 of the DSU. The Panel, it is alleged, disregarded or distorted the evidence with regard to both the MGA and the other five hormones at issue supplied by the Panel's experts, as well as the scientific evidence presented by the European Communities. In support of this contention, the European Communities submits that the Panel has manifestly distorted the views of both Dr. Lucier<sup>17</sup> and Dr. André.<sup>18</sup> According to the European Communities, contrary to what the Panel found, the evidence provided to the Panel by the majority of its own scientific experts indicated that there was a real risk of adverse effects arising from the use of the hormones at issue. It is also claimed that the Panel manifestly distorted the scientific evidence by considering that the 1995 European Communities Scientific Conference on Growth Promotion in Meat Production (the "1995 EC Conference") amounted to a risk assessment in the sense of Articles 5.1 and 5.2. The distinction made by the Panel between general studies on the health risks associated with hormones and specific studies addressing the health risks of residues in food of hormones used for growth promotion purposes was, in the view of the European Communities, devised by the Panel for the sole purpose of enabling it to conclude that the Monographs of the International Agency for Research on Cancer ("IARC")<sup>19</sup> are not relevant as a risk assessment in this case. This, the European Communities asserts, amounts to a distortion of relevant scientific evidence. The European Communities also alleges that the Panel violated Article 11 of the DSU by discarding several articles and opinions of individual scientists invoked by the European Communities.

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<sup>17</sup>See, in particular, US Panel Report, footnote 331; Canada Panel Report, footnote 437.

<sup>18</sup>See, in particular, US Panel Report, footnote 348; Canada Panel Report, footnote 455.

<sup>19</sup>The 1987 Monographs of the IARC on the Evaluation of Carcinogenic Risks to Humans, Supplement 7 (the "1987 IARC Monographs").

18. With regard to the problems relating to the control of the correct use of the hormones, the European Communities contends that it submitted convincing specific evidence to the Panel, but that the Panel either failed to take this evidence into account or failed to summarize it properly in the Panel Report. Finally, the Panel allegedly ignored the arguments made by the European Communities as to why the situations compared by the Panel under Article 5.5 were not comparable. In rejecting the six reasons advanced by the European Communities as to why the distinction in the levels of sanitary protection between carbadox and olaquinox, on the one hand, and the hormones at issue in this dispute, on the other, is not arbitrary or unjustifiable, the European Communities argues that the Panel failed to take into account the evidence before it.

#### 5. Temporal Application of the SPS Agreement

19. The European Communities states that the Panel's conclusion that the SPS Agreement applies to measures that were enacted before the entry into force of the SPS Agreement but that did not cease to exist after that date, is too sweeping.<sup>20</sup> According to the European Communities, the SPS Agreement shows a different intention in some of its provisions, at least if these provisions are interpreted in the way proposed by the Panel. Articles 5.1 to 5.5 require that certain preparatory actions and procedures be followed before a measure is adopted and obligations of this kind are exhausted once the measures under consideration are adopted. The European Communities, therefore, concludes that the SPS Agreement does not apply to the procedure for the elaboration of the EC measures at issue in this dispute.

#### 6. Article 3.1

20. The European Communities submits that the Panel erred in interpreting the term "based on" in stating that Article 3.2 "equates" measures "based on" international standards with measures which "conform to" such standards.<sup>21</sup> The European Communities asserts that these terms differ in their meaning.

21. It is pointed out by the European Communities that Article 3 employs the term "based on" in paragraphs 1 and 3, whereas it uses the term "conform to" in paragraph 2. Also, Article 2 distinguishes between "based on" (paragraph 2) and "conform to" (paragraph 4). This differing language in consecutive paragraphs of different articles cannot be accidental.

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<sup>20</sup>US Panel Report, paras. 8.25 and 8.26; Canada Panel Report, paras. 8.28 and 8.29.

<sup>21</sup>US Panel Report, para. 8.72; Canada Panel Report, para. 8.75.

22. To the European Communities, a measure may deviate -- but not substantially -- from the content of a recommendation of the Codex and still be considered as "based on" that recommendation for the purposes of Article 3.1. However, what constitutes a "substantial" deviation is not defined in the SPS Agreement. The submission of the European Communities is that Article 3 of the SPS Agreement accomplishes its object of furthering international harmonization by allowing Members to choose one of three alternative options. First, a Member may opt to conform its sanitary measures to the Codex recommendations, in accordance with Article 3.2. Second, a Member may wish merely to "base [its] sanitary ... measures on international ... recommendations", in accordance with Article 3.1, instead of conforming to such recommendations. Third, a Member may decide, in accordance with Article 3.3, to establish sanitary measures which provide a "higher level of sanitary protection" than would measures "based on" the Codex recommendations. As noted above<sup>22</sup>, it is firm view of the European Communities that these three options are of equal standing and that Article 3.3 cannot be qualified as an exception to Article 3.1. The European Communities therefore objects to the Panel's interpretation of and conclusions concerning Article 3.1.

#### 7. Article 3.3

23. The European Communities contends that the Panel's finding that whatever the difference might be between the two exceptions in Article 3.3, a sanitary measure can only be justified under this provision if it is consistent with the requirements contained in Article 5<sup>23</sup>, in effect reduces the two alternative conditions in the first sentence of Article 3.3 to "mere surplusage". According to the European Communities, Article 3.3 defines the concept of the first condition ("scientific justification") in the footnote thereto without making a direct reference to Article 5, paragraphs 1 to 8, as it does with respect to the second condition ("as a consequence of choosing a higher level of protection"). The absence in the footnote to Article 3.3 of language referring to Articles 5.1-5.8 is in itself sufficient indication of the intention of the drafters to qualify the application of Article 5 in the case of the first condition. Thus, the European Communities asserts, the plain meaning and structure of Article 3.3 imply that the risk assessment requirements of Article 5 apply only if the second of these two alternative conditions is met.

#### 8. Article 5.1

24. The European Communities contests the Panel's finding that Article 5.1 requires a Member imposing an SPS measure to submit evidence that it "look into account" a risk assessment when it enacted or maintained a measure<sup>24</sup>, since neither the ordinary meaning of the words "based on", in context, nor the object and purpose of Article 5, suggest a "minimum procedural requirement" under Article 5.1.

25. The European Communities contends that to require concrete evidence in the preamble of the EC Directives or some other evidence that the European Communities actually considered the scientific studies in enacting or maintaining the measures at issue is unreasonable and arbitrary, and runs counter to the object and purpose of Article 5 and the SPS Agreement. There is no legal authority for the Panel's interpretation that risk assessment cannot be on-going and therefore no reason for restricting risk assessment to "old evidence". The European Communities asserts that there is a legitimate SPS goal of providing an opportunity for potentially affected Members to produce scientific evidence relevant to particular measures, and of ensuring consideration of that evidence by the Member adopting the SPS measure. Therefore, the European Communities submits that all parties and third parties should have the right to present "new" relevant evidence to the Panel.

26. With regard to the Panel's findings on the consistency of the import prohibition with the substantive requirements of Article 5.1, the European Communities claims that the Panel erred in its interpretation of Article 5.1 in six separate respects. First, the Panel was incorrect in distinguishing between studies that specifically address the hormones for growth promotion purposes, such as the 1982 Report of the EC Scientific Veterinary Committee<sup>25</sup> (the "Lamming Report") and the JECFA Reports<sup>26</sup>, and studies which relate to hormones in general, such as the 1987 IARC Monographs and articles and opinions of individual scientists referred to by the European Communities.<sup>27</sup> The Panel's assumption that such a distinction makes a qualitative difference in terms of risk assessment is wrong, and the distinction is arbitrary. The European Communities argues that Articles 5.1 and 5.2 neither prescribe risk assessment techniques nor specify the requirements of a risk assessment.

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<sup>24</sup>US Panel Report, para. 8.113; Canada Panel Report, para. 8.116.

<sup>25</sup>1982 Report of the EC Scientific Veterinary Committee, Scientific Committee for Animal Nutrition and the Scientific Committee for Food on the basis of the Report of the Scientific Group on Anabolic Agents in Animal Production.

<sup>26</sup>Evaluation of certain veterinary drug residues in food: Thirty-second Report of the Joint FAO/WHO Expert Committee on Food Additives, Technical Report Series 763 (World Health Organization, 1988); and the evaluation of certain veterinary drug residues in food: Thirty-fourth Report of the Joint FAO/WHO Expert Committee on Food Additives, Technical Report Series 788 (World Health Organization, 1989).

<sup>27</sup>Para. 11 of this Report.

<sup>28</sup>US Panel Report, para. 8.83; Canada Panel Report, para. 8.86.

<sup>29</sup>US Panel Report, paras. 8.127 and 8.130; Canada Panel Report, paras. 8.130 and 8.133.

27. Second, the Panel's view of Article 5.1 as imposing a substantive obligation on Members to conform their SPS measures to the conclusions reflected in the JECFA Reports or the reports of other scientific committees is manifestly incorrect. The "scientific basis" of SPS measures cannot be confined to the formalized conclusions of committees called upon to review or analyze the risks a substance may pose. Those conclusions are just one of the elements to be taken into account. The "available scientific evidence", referred to in Article 5.2, includes both generally held or majority scientific views as well as minority, or dissenting, scientific opinion (often first expressed by individual scientists). The European Communities also controverts the Panel's finding that the reports of the European Parliament are "non-scientific"<sup>28</sup>, and contends that this finding is manifestly wrong, certainly as regards the so-called Pimenta Report.<sup>29</sup>

28. Third, the Panel's interpretation that "based on" within the meaning of Article 5.1 means "in conformity with" is mistaken.<sup>30</sup> The European Communities states that reports of scientific committees frequently say practically nothing or very little on some of the factors indicated in Articles 5.1 and 5.2. To the European Communities, Article 5.1 is designed to compel Members to have some plausible scientific rationale as the "basis" for their sanitary measures, but not to conform their measures absolutely to the technical and scientific conclusions of the reports.

29. Fourth, the European Communities contends that the "most fundamental error of interpretation" of the Panel relates to the concept of risk and risk assessment.<sup>31</sup> "Risk" does not mean "harm" or "adverse effect". "Risk", for the purposes of the SPS Agreement, is the "potential" for the harm or adverse effects arising and, therefore, the mere possibility of risk arising suffices for the purposes of Articles 5.1 and 5.2. A risk evaluated to be one in a million is sufficient justification. If there is a potential for adverse effects (no matter how small), then there is, according to the European Communities, a risk. The concept of risk in the SPS Agreement is a qualitative, not a quantitative concept. Any identified increase in cancer (whether quantitative or qualitative) must be sufficient to constitute a risk against which WTO Members are entitled to protect their population.

30. Fifth, the European Communities disputes the Panel's finding that the problem of control is irrelevant to risk assessment<sup>32</sup>, as contrary to common sense and to the express language of Article 5.2

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<sup>28</sup>US Panel Report, para. 8.109; Canada Panel Report, para. 8.112.

<sup>29</sup>European Parliament, Session Documents, Report drawn up on behalf of the Committee of Inquiry into the Problem of Quality in the Meat Sector, Rapporteur: Mr. Carlos Pimenta, Document A2-11/89/PARTS A-B, March 1989 ("Pimenta Report").

<sup>30</sup>US Panel Report, para. 8.117; Canada Panel Report, para. 8.120.

<sup>31</sup>As reflected in para. 8.124 of the US Panel Report and para. 8.127 of the Canada Panel Report.

<sup>32</sup>US Panel Report, para. 8.146; Canada Panel Report, para. 8.149.

and Annex C of the SPS Agreement clarifies. The European Communities also points out that the condition "in accordance with good veterinary practice" is part of the content of the Codex recommendation, and that effective control is necessary to ensure that the hormones at issue are administered in accordance with good practice. Evaluation of any potential risk arising from lack of observance of good practice is an inherent part of the risk assessment exercise. Moreover, it was for the European Communities, and not for the Panel, to determine whether the control measures of an exporting Member are adequate to achieve the EC's appropriate level of sanitary protection. The Panel has disregarded the EC's arguments relating to the practical and technical difficulties that are specific to control of the hormones at issue. The European Communities also protests as an error in law the Panel's conclusion that banning the use of a substance does not necessarily offer better protection of human health than other means of merely regulating its use.

31. Finally, the European Communities submits that the Panel was manifestly wrong in finding that a risk assessment must be carried out for each individual substance.<sup>33</sup> Nowhere in the SPS Agreement, and in particular in Articles 5.1 and 5.2, is there language requiring a risk assessment "for each individual substance". In the view of the European Communities, there is nothing to prevent classes or categories of substances from being assessed together if this is scientifically justified.

#### 9. Article 5.5

32. The European Communities argues that the Panel erred in its interpretation of Article 5.5. With respect to the first element, namely, the existence of different levels of protection in different situations, the Panel erroneously interpreted Article 5.5 in holding that situations involving the same health risk or substance are comparable situations for the purposes of Article 5.5.<sup>34</sup> The European Communities submits that it is inappropriate to compare the level of protection relating to hormones used for growth promotion purposes with the level of protection relating to naturally-occurring hormones. Science and the regulatory practices of Members do not treat man-made risks, such as the risks created by hormones used for growth promotion, and naturally-occurring risks, such as those arising from the presence of hormones in meat, milk, cabbage or broccoli, in the same way. The SPS Agreement applies only to man-made risks because the naturally-occurring hormones in meat and other foodstuffs are not "contaminants and toxins" within the meaning of the SPS Agreement. Furthermore, the European Communities submits

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<sup>33</sup>US Panel Report, para. 8.257; Canada Panel Report, para. 8.260.

<sup>34</sup>US Panel Report, para. 8.176; Canada Panel Report, para. 8.179.

that, contrary to what the Panel found<sup>35</sup>, there is no difference, let alone a significant difference, in the EC level of protection against naturally-occurring hormones and its level of protection against added hormones. The EC measures provide for the same level of protection against naturally-occurring hormones and added hormones, namely, the risk determined by nature.

33. In respect of the second element of Article 5.5, namely, the arbitrary or unjustifiable nature of distinctions in levels of protection, the European Communities contends that the Panel has erroneously assumed that the only factors relevant to determining what is an arbitrary or unjustifiable distinction are "scientific" factors. Other factors, such as public perception of what is dangerous and of what level of risk is acceptable, and the benefit, if any, to be gained from shouldering a risk, must also be relevant. Moreover, the European Communities argues that, contrary to what the Panel found<sup>36</sup>, the distinction between the level of protection adopted in respect of the hormones at issue when used for growth promotion and the level of protection adopted with respect to carbadox and olaquinodox is not arbitrary or unjustifiable.

34. As to the third element of Article 5.5, namely discrimination or a disguised restriction on international trade resulting from the distinction in the levels of protection, the European Communities objects to the Panel's finding that it was sufficient to demonstrate "the significance of the difference in levels of protection combined with the arbitrariness thereof".<sup>37</sup> Article 5.5 makes a resultant "discrimination or a disguised restriction on international trade" an additional element beyond arbitrary and unjustifiable distinctions in the levels of protection a Member considers appropriate. The European Communities does not consider the approach developed by the Appellate Body in Japan - Taxes on Alcoholic Beverages<sup>38</sup> ("Japan - Alcoholic Beverages") and invoked by the Panel in this case as appropriate for the very different problem in determining discrimination (between countries) and a disguised restriction of trade in a regulatory regime designed to protect human health.

35. Furthermore, it is argued by the European Communities that Article 5.5 must be interpreted together with Article 2.3 of the SPS Agreement. Accordingly, "discrimination" in Article 5.5 means "discrimination between States where identical or similar conditions prevail". The Panel ignored Article 2.3 and assumed that discrimination can be between substances, risks and levels of protection. This assumption cannot

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<sup>35</sup>US Panel Report, paras. 8.191 and 8.212; Canada Panel Report, paras. 8.194 and 8.215.

<sup>36</sup>US Panel Report, para. 8.238; Canada Panel Report, para. 8.241.

<sup>37</sup>US Panel Report, para. 8.184; Canada Panel Report, para. 8.187.

<sup>38</sup>Adopted 1 November 1996, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R.

be correct since otherwise the term "discrimination" would add nothing to "arbitrary and unjustifiable distinctions", in the view of the European Communities.

36. The European Communities stresses that there is no import ban for beef as such and that the restriction applies only to non-conforming products. This is the inevitable consequence of any SPS measure, and cannot be enough to establish a "disguised restriction on international trade". The European Communities continued to import the same amount of meat after the ban as before, and the prohibition of hormones for growth promotion has no effect on the surpluses of beef. The suggestion of the Panel that the reduction of beef surpluses in the European Communities might have been a secondary motive, is, in any event, not sufficient to establish the discrimination or disguised restriction on international trade contemplated in Article 5.5. Finally, the European Communities submits that the fact that 70% of the bovine meat produced in the United States and Canada is from cattle to which hormones have been administered for growth promotion is no indication of a disguised restriction on trade.

#### 10. Procedural Issues

37. The European Communities asserts that a number of procedural decisions taken by the Panel were unfair and require review by the Appellate Body. The European Communities objects to the Panel's view that it need consider the EC's procedural objections only where the European Communities could make a "precise claim" of prejudice.<sup>39</sup> The Panel should have asked itself whether its procedural decisions were consistent with the DSU, not whether the European Communities could make a precise claim of prejudice. It is asserted by the European Communities that the Panel committed a legal procedural error in refusing to accept the scientific assessments of the European Communities, declining to set up an expert review group, and proceeding to decide itself a scientific matter on which the Panel had no expertise. The Panel's decision to receive a range of opinions from individual experts<sup>40</sup> deprived the European Communities of the procedural guarantees provided for expert review groups in the DSU. By following this procedure, the Panel put itself in a position to choose freely between different scientific opinions. The European Communities contends that the selection of scientific experts by the Panel violated Articles 11, 13.2 and Appendix 4 of the DSU as well as Article 13.2 of the SPS Agreement. The European Communities objects to the selection of two experts on the grounds that one of them was a national of a party or third party and had links with the pharmaceutical industry, while the other was a member of the Codex/JECFA group that had produced the report on the use of hormones in animal growth promotion

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<sup>39</sup>US Panel Report, paras. 8.14-8.15; Canada Panel Report, paras. 8.18-8.19.

<sup>40</sup>US Panel Report, para. 8.7; Canada Panel Report, para. 8.7.

and was the "rapporteur" of this study. Further, according to the European Communities, these two experts lacked expertise in the field.

38. The European Communities also alleges that the Panel erred in refusing to request that Canada and the United States provide the studies on which their authorities had based their decisions to authorize the use of MGA for growth promotion. In the view of the European Communities, the Panel had a duty to carry out an objective assessment of the facts, and declining to request the complainants to produce the evidence on which they based their own domestic decisions is not compatible with this duty. Moreover, Article 18.2 of the DSU provides safeguards for the protection of confidential information. Thus, the allegedly confidential nature of the information on MGA should have been no obstacle to its production and use in the proceeding. The European Communities also asserts that the Panel based the main part of its reasoning concerning Article 5.5 of the SPS Agreement on a claim that the complainants had not made, i.e. that there was a difference of treatment between artificially-added, or exogenous, natural and synthetic hormones when used for growth promotion purposes and the naturally-present endogenous hormones in untreated meat and other foods (such as milk, cabbage, broccoli or eggs). In the view of the European Communities, not only is this "claim" wrong in law and in fact, but the Panel also violated the DSU in relying on it especially since the United States expressly protested against the Panel's use of such a "claim". The European Communities asserts that panels are not entitled to make findings going beyond what has been requested by the parties.

39. The European Communities submits further that the Panel took a number of decisions granting "extended third party rights" to Canada and the United States -- and not to other third parties -- that are not justified by Article 9.3, and are contrary to Articles 7.1, 7.2, 18.2 and 10.3 of the DSU as well as the terms of reference of the Panel. These decisions were: first, to give access to all of the information submitted in the United States' proceeding to Canada; second, to give access to all the information submitted in the Canadian proceeding to the United States; third, to hold a joint meeting with the scientific experts; and fourth, to invite the United States to observe and make a statement at the second substantive meeting in the proceeding initiated by Canada.

B. Arguments by the United States - Appellee

1. Burden of Proof

40. With regard to the allocation of the burden of proof under Article 3.3 of the SPS Agreement, the United States refers to the Appellate Body Report in *United States - Shirts and Blouses*<sup>41</sup> and argues that, like Articles XX and XI:2(c)(i) of the GATT 1994, Article 3.3 of the SPS Agreement is not a positive rule establishing an obligation in itself. It is in the nature of an affirmative defence, and the Panel was therefore correct in finding that the burden of proof under Article 3.3 rests on the defending party. As to the burden of proof under Article 5.1 of the SPS Agreement, the United States contends that the European Communities, in complaining that Canada and the United States did not provide their confidential information concerning MGA, misses the point that the Panel had to determine whether the European Communities had based its import ban on a risk assessment.

2. Standard of Review

41. The United States submits that the deferential "reasonableness" standard of review advocated by the European Communities is without support in the text of either the DSU or the SPS Agreement. The United States observes that, under Article 5.1, the Panel was called upon to determine if the EC ban was "based on" an assessment, as appropriate to the circumstances, of the risks to human health. Such a determination does not require a panel to conduct its own risk assessment or substitute its own judgement regarding risks, but only to determine if the measure is "based on" a risk assessment. Under Article 2.2, the question for a panel is not whether it would have come to a different conclusion "based on" the evidence, but rather whether the scientific evidence submitted by the Member maintaining the measure is "sufficient" as a basis for that measure. The United States believes that in this sense, the European Communities is correct in asserting that a panel is not to conduct a de novo review of the scientific basis of the measure.

42. The United States argues, however, that nothing in the SPS Agreement or the WTO Agreement requires a Panel to defer to the Member maintaining the SPS measure. In examining measures under the Agreement on Textiles and Clothing (the "ATC"), which, like the SPS Agreement, does not provide for a particular standard of review, two previous panels found that it would not be appropriate either to apply a de novo standard of review or to grant undue deference to the administrative findings of national authorities.<sup>42</sup> The United States cautions that the GATT panel reports cited by the European Communities, involving anti-dumping and countervailing duty disputes, do not support the existence of a deferential

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<sup>41</sup> Adopted 23 May 1997, WT/DS33/AB/R, pp. 14 and 16.

<sup>42</sup> The United States refers to: Panel Report, *United States - Underwear*, adopted 25 February 1997, WT/DS24/R; and Panel Report, *United States - Shirts and Blouses*, adopted 23 May 1997, WT/DS33/R.

standard of review in the SPS Agreement. Those GATT panel reports involved situations where national authorities had taken anti-dumping or countervailing duty measures pursuant to detailed national legislation and procedures mandated by the Tokyo Round Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade (the "Tokyo Round Anti-Dumping Code"). According to the United States, the Decision on Review of Article 17.6 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 shows that Members have yet to decide if the standard of review set out in Article 17.6 of the Anti-Dumping Agreement is capable of general application. The United States asserts that the European Communities is mistaken in arguing that this standard of review applies to the SPS Agreement.

3. The Precautionary Principle

43. In the view of the United States, the claim of the European Communities that there is a generally-accepted principle of international law which may be referred to as the "precautionary principle" is erroneous as a matter of international law. The United States does not consider that the "precautionary principle" represents a principle of customary international law; rather, it may be characterized as an "approach" -- the content of which may vary from context to context. The SPS Agreement does recognize a precautionary approach; indeed, Article 5.7 permits the provisional adoption of SPS measures even where the relevant scientific evidence is insufficient. Thus, the United States believes that there is no need to invoke a "precautionary principle" in order to be risk-averse since the SPS Agreement, by its terms, recognizes the discretion of Members to determine their own level of sanitary protection. The European Communities does not explain how "the precautionary principle" affects the requirements in the SPS Agreement that a measure be "based on" scientific principles and a risk assessment, and not maintained without sufficient scientific evidence. The EC's invocation of a "precautionary principle" cannot create a risk assessment where there is none, nor can a "principle" create "sufficient scientific evidence" where there is none.

4. Objective Assessment of the Facts

44. According to the United States, the European Communities improperly requests the Appellate Body to review the Panel's factual findings to determine whether they were either "inadequate" or "not objective", and thus inconsistent with Article 11 of the DSU. The United States submits that, according to Article 17.6 of the DSU, factual findings are clearly beyond review by the Appellate Body. Furthermore, the

United States contends that the European Communities has not shown either improper influence or conflict of interest that might warrant consideration of the objectivity of the Panel.

5. Temporal Application of the SPS Agreement

45. The United States argues that the European Communities, in claiming that Articles 5.1 to 5.5 do not apply to SPS measures adopted before the SPS Agreement entered into force, has misread the SPS Agreement. There is no support for this claim in the text, context or negotiating history of the SPS Agreement. If the position of the European Communities were accepted, this would, in the view of the United States, leave a gaping exception to the disciplines of the SPS Agreement.

6. Article 3.1

46. According to the United States, since the EC measures are not "based on" the Codex standards, even under the broad test of "based on" proposed by the European Communities, there is no need for the Appellate Body to address the alleged difference between measures "based on" international standards and measures that "conform to" international standards. The United States recognizes that Article 3 of the SPS Agreement uses the two different terms in Articles 3.1 and 3.2, but suggests that whether any theoretical difference between those two terms would have any meaning in practice is a question for another case.

7. Article 3.3

47. The United States believes that the European Communities is incorrect in claiming that its ban need not be "based on" a risk assessment under Article 5.1 in order to qualify under Article 3.3 as a measure for which there is a "scientific justification" for departing from an international standard. A risk assessment provides the necessary "examination and evaluation of available scientific information" required in the footnote to Article 3.3. The European Communities provides no explanation why the "relevant provisions" of the SPS Agreement, referred to in that footnote, do not include Article 5.1. The context of the footnote to Article 3.3 includes the definition of "risk assessment" in Annex A of the SPS Agreement. According to the United States, the fact that Articles 5.1 and 5.2 relate to conducting a risk assessment make it clear that these Articles are "relevant provisions" of the SPS Agreement for purposes of the footnote, and that any doubt regarding the applicability of Article 5.1 is removed by the last sentence of Article 3.3.

8. Article 5.1

48. The United States maintains that the Panel's finding that there is a "procedural requirement" inherent in Article 5.1 is simply a common sense reading of Article 5.1. It would be difficult to see how a measure is "based on" a risk assessment if the Member did not even know of the existence of the risk assessment or never considered the risk assessment in enacting or maintaining the measure. Furthermore, the Panel Report should not be read as imposing a rigid requirement to be satisfied only by referring to the risk assessment in the preamble to the measure. Such a reference, the United States contends, is simply one means of demonstrating that a risk assessment was taken into account.

49. The Panel was correct, according to the United States, in finding that in order that a measure may be "based on" a risk assessment, the scientific principles underlying the measure must reflect the scientific conclusions reached by the scientists conducting the risk assessment. The United States submits that the European Communities did not, at any time during the panel proceedings, produce a risk assessment identifying any risk. In the case of the hormone MGA, it is even more obvious that the EC ban is not "based on" a risk assessment.

50. With regard to the problems of control of correct use of the hormones, the United States submits that the Panel correctly characterized the argument of the European Communities as being a general statement that there is no guarantee of 100 percent compliance with any system of laws. Such a generalized concern is not an adequate basis for the EC ban. Furthermore, there is no evidence that the control of the hormones at issue is more difficult than the control of other veterinary drugs (the use of which is allowed), or that control is more difficult under a regime where hormones are allowed for growth promotion under specific conditions than under a current regime where they are banned. During the oral hearing, the United States observed that the scientific studies indicated that the hormones are safe when used in accordance with good practice. According to the United States, these studies do not address the question of whether the hormones at issue are unsafe when not used in accordance with good practice.

51. As to whether a separate risk assessment is necessary for each particular substance, the United States submits that under Article 5.1, the European Communities must base its ban with respect to MGA on an "evaluation, as appropriate to the circumstances, of the potential for adverse effects on human health arising from the presence of residues of MGA in meat ...". The European Communities provided no such evaluation of MGA. The scientific studies that the European Communities referred to deal with a general class of compounds, and do not deal specifically with MGA.

9. Article 5.5

52. The United States supports the finding that the situation involving carbadox and the situation involving the six hormones at issue are different situations which can nonetheless be compared for the purposes of Article 5.5. To the United States, the Panel was correct in finding that the EC distinction in the levels of protection involving carbadox and the level of protection involving the hormones at issue was arbitrary and resulted in a disguised restriction on international trade. In coming to that conclusion, the Panel found that the hormones at issue, banned in the European Communities, were used for growth promotion purpose in the bovine meat sector where the European Communities wanted to limit supplies and was arguably less concerned with international competitiveness while carbadox, allowed in the European Communities, is used for growth promotion purposes in the pork meat sector where the European Communities has no domestic surpluses and where international competitiveness is a high priority. The United States claims that this issue relates to factual findings that are not reviewable by the Appellate Body.

10. Procedural Issues

53. The United States asks the Appellate Body to dismiss each of the procedural claims raised by the European Communities. The appeal by the European Communities on these issues, the United States claims, raises a threshold question as to whether, and if so, under what circumstances, the procedures employed by the Panel during the proceeding could be considered to be issues of law covered in the Panel Report or legal interpretations developed by the Panel within the meaning of Article 17.6 of the DSU. The United States asserts that the European Communities has not pointed to any textual basis for its arguments, nor to any past practice under the GATT 1947 or the WTO Agreement. The United States submits that, to sustain a claim that a panel's handling of procedural issues was inconsistent with the DSU, a party to a dispute must have raised objections in a timely manner during the panel proceeding, if feasible. In the view of the United States, any other response to procedural objections will weaken the authority of panels and destabilize the dispute settlement system. It would also be fundamentally unfair to permit a party to wait and see what the outcome of a panel proceeding is and make its procedural objections only when it is too late for the panel to address them. The United States urges that the objections raised by the European Communities should be rejected to the extent that they were not first made to the Panel.

54. With respect to the EC's objection concerning the Panel's selection of experts, the United States observes that during the panel proceeding, the European Communities did not object to the participation

of two experts who are not only nationals of the Member States of the European Union, but are also employed by institutions of such Member States. As to the EC's objection to the alleged links of one of the experts to the pharmaceutical industry, the United States asserts that the European Communities did not question these links at the time this expert's name was raised by the Panel, even though the European Communities expressed similar concerns at that time with regard to two other scientists proposed by the Panel.

55. Turning to the issue of whether a procedural objection should be based on a "precise claim" of prejudice, the United States believes that while a Panel clearly has the duty of following the relevant rules of the DSU and the covered agreements, a party seeking the reversal or a modification of a procedural ruling should assume the responsibility of providing concrete reasons and legal arguments justifying its objection. Otherwise, every procedural ruling of a Panel could be subject to objections posed for unspecified reasons.

56. The United States asserts that the Panel's decision to consult individual experts, instead of convening an expert review group, was consistent with the DSU and the SPS Agreement. The European Communities itself concedes that Article 13 of the DSU and Article 11.2 of the SPS Agreement are permissive, and not mandatory, provisions. The United States contends that the Panel was not required to convene an expert review group, either under the terms of Article 13 of the DSU or Article 11.2 of the SPS Agreement. If the Panel had convened an expert review group, the rules and procedures of Appendix 4 of the DSU would have been applicable. Since the Panel did not convene such a group, the Panel's decision not to follow the rules and procedures of Appendix 4 was completely consistent with the DSU and was within the discretion accorded to panels in their procedural decisions.

57. The United States contends that the Panel's harmonization of the two panel proceedings did not impair the rights of defence of the European Communities. The use of the same panelists for both proceedings accorded a procedural advantage to the European Communities. According to the United States, rather than having two meetings with each of the two separate Panels, the European Communities was able to have four sessions with the same Panel. The European Communities willingly agreed to have the same panelists in both proceedings.

58. With respect to the issue of extended third party rights, the United States submits that the European Communities failed to make to the Panel the detailed objections it made for the first time in its appellant's submission. There is no reason why, if one panel may grant such rights in one dispute, another panel

may not also grant such rights in another dispute.<sup>43</sup> The United States believes that there were strong reasons to provide it with extended third party rights in the Canadian panel proceeding. The United States asserts that the European Communities is mistaken in asserting that the Panel's grant of extended third party rights gave the complainants access to documents. Both the United States and the European Communities made public their submissions and statements to the Panel in the United States' panel proceeding, and therefore Canada already had access to all these documents.

### C. Arguments by Canada - Appellee

#### 1. Burden of Proof

59. On the matter of allocation of the burden of proof under the SPS Agreement in general, Canada contends that the Panel adopted the reasoning provided by the Appellate Body in United States - Shirts and Blouses.<sup>44</sup> As to the allocation of the burden of proof under Article 3.3 of the SPS Agreement, Canada insists that the Panel's findings are correct, although it would be more accurate to hold that "... the burden of proof under Article 3.1 shifts to the defending party to show either that the measure in dispute is consistent with the obligation in Article 3.1, or to invoke the exception under 3.1 and show that it meets the conditions of that exception".<sup>45</sup> Should the Appellate Body reverse or modify the Panel's findings on the burden of proof, Canada submits that in any event, Canada has established a prima facie case of violation. With regard to the burden of proof under Article 5.1 of the SPS Agreement, Canada believes that it had provided sufficient evidence concerning the import ban on meat treated with MGA to establish a prima facie case.

#### 2. The Precautionary Principle

60. The Panel did not take a position on whether the "precautionary principle" constituted part of the body of international law. Rather, in Canada's view, the Panel acknowledged that the "precautionary principle" was reflected in Article 5.7 of the SPS Agreement, and correctly held that the "precautionary principle" could not override Articles 5.1 and 5.2, or any other provision of the SPS Agreement. Canada also regards the issue of whether the "precautionary principle" is "built into" other provisions of the SPS

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<sup>43</sup>The United States refers to Panel Report, European Communities - Regime for the Importation, Sale and Distribution of Bananas, adopted 25 September 1997, WT/DS27/R/USA ("European Communities - Bananas").

<sup>44</sup>Adopted 23 May 1997, WT/DS33/AB/R.

<sup>45</sup>Canada's appellee's submission, para. 59.

Agreement as irrelevant in this appeal. Moreover, the European Communities has not explained what is meant by the "precautionary principle" having been "built into" other provisions of the SPS Agreement, and how this could in any way affect the conclusions of the Panel. The "precautionary principle" should be characterized as the "precautionary approach" because it has not yet become part of public international law. Canada considers the precautionary approach or concept as an emerging principle of international law, which may in the future crystallize into one of the "general principles of law recognized by civilized nations", within the meaning of Article 38(1)(c) of the Statute of the International Court of Justice.

3. Objective Assessment of the Facts

61. Canada submits that many of the claims made by the European Communities in its appellant's submission purport to be claims relating to errors of law but are in reality claims alleging errors of fact. The Appellate Body made it clear in its Report in European Communities - Bananas<sup>46</sup>, that factual findings are, pursuant to Article 17.6 of the DSU, beyond review by the Appellate Body.

4. Temporal Application of the SPS Agreement

62. Canada argues that the distinction drawn by the European Communities between provisions of the SPS Agreement that include the terms "maintain" or "apply", and others that do not, is not sustainable. This dichotomy presented by the European Communities would mean that measures in existence on 1 January 1995 are indefinitely exempt from the disciplines of Articles 5.1 and 5.5, but it is hardly credible that the Members intended to exempt them. Other covered agreements contain specific provisions dealing with temporal issues, therefore, non-application of provisions of the SPS Agreement, such as Articles 5.1 and 5.5, would have been dealt with expressly in the text of the SPS Agreement. In any event, the EC measures at issue in this dispute include EC Directives 96/22/EC and 96/23/EC, which were adopted after the WTO Agreement entered into force.

5. Article 3.1

63. Canada maintains that the EC's argument that Article 3.1 does not constitute a "general obligation", but is one of three options available to Members when Codex recommendations exist, is incorrect. Article 3.1 sets out a positive obligation for Members to base their SPS measures on international standards,

guidelines or recommendations. The words of Article 3.1 do not describe three "options". If the drafters of the agreement had intended such a meaning, they would have said so. Canada supports the Panel's conclusion that the terms "conform to" and "based on" are "co-extensive". Even if the Appellate Body accepts the view that "conforms to" is narrower in scope than "based on", Article 3.1 does not present a second "option", as argued by the European Communities. A measure that "conforms to" an international standard would also be "based on" that standard.

6. Article 3.3

64. The key element of the footnote to Article 3.3 is that it requires an examination and evaluation of available scientific information. Since the SPS Agreement defines a risk assessment as: "the evaluation of the potential for adverse effects on human ... health ...", the "examination and evaluation of scientific information" in the footnote to Article 3.3 refers to a risk assessment. A Member cannot, in Canada's view, determine that the relevant international standards are not sufficient to achieve its appropriate level of sanitary protection unless the Member does an evaluation of that risk (i.e. a risk assessment), taking into account available scientific evidence.

7. Article 5.1

65. Canada considers that the Panel's interpretation of Article 5.1 accords with the ordinary meaning of the words in their context. If a measure is "founded on" a risk assessment then there must be some evidence that the measure was built upon that foundation. Such a requirement would not amount to "freezing the scientific record", since the Panel made clear that it was looking for evidence that a risk assessment was taken into account when the EC measures were established or at any later point in time. In Canada's view, the Panel's reading of Article 5.1 is sound, and accords with the basic obligations set out in Article 2.2 that a measure must not be maintained without sufficient scientific evidence. If the scientific conclusions reflected in the EC measures do not conform with any of those reached in the risk assessments, then the scientific foundation for the measure clearly does not come from those risk assessments.

66. Canada submits that in defining what is a risk assessment, the European Communities focuses on the word "potential" to the exclusion of "evaluation". In doing so, the European Communities has stopped the process at identifying an adverse effect without carrying out the evaluation of the risk, i.e. performing a risk assessment.

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<sup>46</sup>A.adopted 25 September 1997, WT/DS27/AB/R.

67. At the oral hearing, when asked about the need for a separate risk assessment of each individual substance, Canada opined that one can use characteristics of chemical families as a starting point for exploring whether something might pose a hazard, but it is then necessary to go on and do a full evaluation of that chemical in order to determine whether it in fact poses a hazard.

8. Article 5.5

68. According to Canada, the scope of "different situations" referred to in Article 5.5 is at least as broad as the Panel found. The limited scope suggested by the European Communities conflicts with the ordinary meaning of "different situations". Canada also submits that in the light of the object and purpose of the SPS Agreement and the context of Article 5.5, there is no reason to limit the scope of comparison between levels of protection for human health. In Canada's view, the Panel correctly found that the European Communities had not justified the distinctions in its purported levels of protection. The Panel did not "confine" the range of factors to be taken into consideration; the Panel considered all the arguments the European Communities had provided, but found them wanting. Canada contests the argument of the European Communities that the significance of the difference in levels of protection is no guide to the significance of trade effects. No measure could be more trade restrictive than an import ban.

9. Procedural Issues

69. Canada submits that all of the procedural rulings made by the Panel were fair to all the parties, did not result in any prejudice or injustice, and were within the Panel's jurisdiction and discretion. In particular, Canada believes that the Panel acted within its jurisdiction in making comparisons and findings with respect to the levels of protection for endogenous natural hormones, even if those precise arguments on Article 5.5 of the SPS Agreement were not made by Canada or the United States. Article 11 of the DSU does not limit the mandate of the Panel by compelling it to use only the arguments made by the parties. A panel is not prevented from making an objective finding that does not correspond to either party's argument.

70. Concerning the Panel's decision to consult experts in their individual capacities, rather than as an expert review group, Canada submits that the process chosen by the Panel ensured that all the views of the experts advising the Panel were brought to the Panel's attention. Far from prejudicing the European Communities, this process gave the European Communities an opportunity to elicit evidence to support

its arguments from any of the Panel's experts. While Article 11.2 of the SPS Agreement provides that in disputes involving scientific or technical issues, a Panel should seek advice from experts chosen by the Panel in consultation with the parties to the dispute, this provision does not require the Panel to accept all expert advice without scrutiny. Canada submits that, to the contrary, the Panel had no authority to delegate its fact-finding duty to the experts in such a manner.

71. It is also submitted by Canada that the objection of the European Communities to the nationality of the experts selected to assist the Panel is without merit. Canada is unaware that the European Communities raised any such objection during the Panel's selection of experts. In Canada's view, by suggesting an expert who was a national of one of its Member States, the European Communities waived its right to object to the other scientists on the basis of their nationality. The Panel's decisions on "extended third party rights" were proper exercises of the Panel's discretion, and are not inconsistent with the DSU. The European Communities made references to materials that it had placed before the US Panel, but did not provide those materials in the Canada Panel proceeding. Thus, according to Canada, rather than prejudice the EC case, the Panel allowed all the submissions by the European Communities before the US Panel to be considered by the Canada Panel. Canada maintains that the decision of the Panel to convene a joint meeting of the experts was also within the discretion of the Panel. The European Communities has failed to demonstrate that it suffered any substantive prejudice as a result of this decision. In Canada's view, pursuant to Article 11 of the SPS Agreement, the Panel was entitled to seek advice from experts chosen by the Panel in consultation with the parties, but was under no obligation to convene a meeting with the experts, either severally or jointly.

D. Claims of Error by the United States - Appellant

1. Article 2.2

72. In its capacity as appellant, the United States submits that the Panel erred because, having made all of the findings necessary to find that the EC measure was inconsistent with Article 2.2, it did not take the final step and declare the import ban to be inconsistent with Article 2.2.<sup>47</sup> Article 2.2 requires the European Communities to have sufficient scientific evidence to support its measure. Since the Panel methodically listed and reviewed all of the scientific evidence presented by the European Communities, and in respect of each piece of evidence made a factual finding that the evidence did not support the EC measure, the United States submits that the Panel should have come to the legal conclusion that the EC

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<sup>47</sup>US Panel Report, para. 8.271.

import prohibition is maintained without sufficient scientific evidence. In the view of the United States, there was no need for the Panel to determine exactly how much scientific evidence is "sufficient" for purposes of Article 2.2. The Panel found that the European Communities had presented no evidence to support its ban; "no evidence" cannot be considered to meet the threshold of "sufficient evidence".

73. In justifying why it made no finding under Article 2.2, the Panel stated that Articles 3 and 5 provide for more specific obligations than the "basic rights and obligations" set out in Article 2. According to the United States, Articles 3 and 5 of the SPS Agreement do not necessarily provide for more specific rights and obligations than all of the "basic rights and obligations" set out in Article 2. Neither Article 3 nor Article 5 says how much evidence is necessary to support an SPS measure. Article 2.2 establishes that quantum of evidence in requiring that measures not be maintained "without sufficient scientific evidence". The United States submits, therefore, that nothing in the text of Articles 2, 3 or 5 indicate that all of the obligations in Article 2 are subsumed under the provisions of Articles 3 and 5.

2. Article 5.6

74. It is urged by the United States that the Panel erred<sup>48</sup> in failing to make a finding under Article 5.6 of the SPS Agreement, and that the Panel's findings on Article 5.5 are sufficient to establish that the EC ban is inconsistent with Article 5.6 of the SPS Agreement. The United States notes that the European Communities prohibits the use of the natural hormones to promote growth, while having no limits on the residues of these exact same substances either naturally-present or used for therapeutic or zootechnical purposes. Since the European Communities accepts the residues of these naturally-occurring hormones in meat as safe, then the EC ban is, in the view of the United States, more trade restrictive than required.

75. The United States also notes that the European Communities prohibits the use of the three synthetic hormones at issue, while permitting the use of similar hormones (the three natural hormones) for therapeutic and zootechnical purposes as well as the use of carbadox, another synthetic compound, for growth promotion purposes. In the view of the United States, the European Communities has, in each instance, chosen the most trade restrictive approach (a ban on trade) with respect to the six hormones for growth promotion purposes. The United States argues that the European Communities could permit residues of these hormones used for growth promotion purposes at the same levels that it permits for other purposes and still achieve its level of protection. The fact that the European Communities permits these levels for these other purposes demonstrates that similarly treating residues from growth promotion would be

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<sup>48</sup>US Panel Report, para. 8.247.

reasonably available to the European Communities and would be technically and economically feasible. Permitting these levels for growth promotion purposes would also be significantly less trade restrictive than the current EC ban.

76. The Panel found that "no scientific evidence is available which concludes that an identifiable risk arises from the use of any of the hormones at issue for growth promotion purposes in accordance with good practice."<sup>49</sup> In the view of the United States, this finding is sufficient in itself to establish that the EC ban is inconsistent with Article 5.6. If there is no identifiable risk from the use of these hormones for growth promotion in accordance with good practice, then the EC ban cannot be necessary to achieve a level of protection from an identified risk. The ban is then, by definition, more trade restrictive than required to achieve the appropriate level of sanitary protection by the European Communities.

E. Claims of Error by Canada - Appellant

1. Article 5.6

77. Canada states that its appeal is designed to safeguard its right to rely on its arguments presented to the Panel with respect to Article 5.6, in the event that the Appellate Body decides to modify or reverse the Panel's findings with respect to Articles 3.1, 5.1 or 5.5 of the SPS Agreement. Canada asserts that the EC measures are inconsistent with Article 5.6 of the SPS Agreement. Canada submits that according to the wording of paragraph 5 of Annex A, Article 5.5 and the object and purpose of the SPS Agreement, if there is no scientific evidence of an identifiable risk, there is no basis on which to adopt a measure to achieve a level of sanitary protection under the SPS Agreement, except as provided in Article 5.7.

78. In Canada's view, if a Member could adopt a level of protection and implement a sanitary measure even if it did not provide scientific evidence of an identifiable risk, no effect could be given to the obligation contained in Article 5 to base measures on an assessment of risks. This approach would undermine the wording and object and purpose of the SPS Agreement. Canada notes that the Panel found that the European Communities had not provided any scientific evidence of an identifiable risk related to the hormones at issue when used for growth promotion purposes in accordance with good practice.<sup>50</sup> If there is no scientific evidence of an identifiable risk, and therefore no basis on which to adopt a measure to achieve a level of sanitary protection under the SPS Agreement, except for Article 5.7, then by definition,

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<sup>49</sup>US Panel Report, para. 8.134.

<sup>50</sup>Canada Panel Report, paras. 8.165 and 8.264.

refer to the quantitative, but rather to the qualitative, aspects of the scientific evidence used by the regulatory authorities of a Member. The use of the words "scientific principles" in the same Article reinforces the view that Article 2.2 and the SPS Agreement in general do not require sanitary measures to be "based on" the "best" scientific evidence or the "weight" of available scientific evidence. The European Communities submits, therefore, that the real question is not whether the sanitary measure is "based on" the "best" science or the "preponderance" of science or whether there is conflicting science. Rather, the question is only whether the government maintaining a measure has a scientific basis for that measure.

2. Article 5.6

82. The European Communities also questions whether the statements of the Panel regarding Article 5.6 amount to an issue of law covered in the Panel Report or a legal interpretation developed by the Panel, for purposes of Article 17.6 of the DSU. Although the Panel's refusal to rule on Article 5.6 rests on a certain view of the Panel regarding the relationship between Articles 2 and 5 of the SPS Agreement, such a refusal places the matter outside the scope of appellate review. The European Communities submits that the Panel did not apply the substantive requirements of Article 5.6, and did not make the necessary factual findings that: first, the EC measures are more trade restrictive than required to achieve the EC's level of protection; secondly, there is another measure reasonably available taking into account technical and economic feasibility; and thirdly, this other measure both achieves the EC's level of sanitary protection and is significantly less trade restrictive. Finally, the European Communities argues that Canada and the United States base their claims on certain paragraphs of the Panel Report that are founded on a manifest misunderstanding or clear distortion of the facts or inadequate reasoning by the Panel, as the European Communities has explained in its appeal.

83. The European Communities is convinced that the EC measures are consistent with Article 5.6 of the SPS Agreement. According to the European Communities, the objective is to ensure that consumers are not exposed to any residues of hormones used for growth promotion purposes. The European Communities acknowledges that some hormones are present naturally and cannot be avoided. It also acknowledges that some hormones are administered to cattle for therapeutic and zootechnical purposes, purposes which are unavoidable and beneficial. However, the European Communities has decided that the exposure of its population to hormones above this level should be avoided, and that in particular, there should be a zero level of tolerance for hormones used for growth promotion purposes.

no SPS measure could be adopted that would not be more trade restrictive than required. In Canada's conclusion, applying the Panel's findings with respect to the six hormones at issue to the requirements of Article 5.6, the EC measures are more trade restrictive than required, and inconsistent with Article 5.6.

F. Arguments by the European Communities - Appellee

1. Article 2.2

79. The European Communities questions whether the statement of the Panel regarding Article 2.2 amounts to an issue of law covered in the Panel Report or a legal interpretation developed by the Panel in the sense of Article 17.6 of the DSU. Although the Panel declined to rule on Article 2.2 because of a legal interpretation reached by the Panel regarding the relationship between Articles 2 and 5 of the SPS Agreement, the refusal by the Panel to rule on Article 2.2 places this statement outside the scope of appellate review. The Panel did not address the substantive requirements of Article 2.2, and has not made the necessary findings on whether the scientific evidence submitted by the European Communities is sufficient. The European Communities agrees with the United States that nothing in the text of Articles 2, 3 and 5 of the SPS Agreement indicates that all of the obligations set out in Article 2 are subsumed under the provisions of Articles 3 and 5. From the factual, procedural and substantive points of view, the questions that need to be considered under Article 2.2 are different from those examined by the Panel under Articles 3.1, 5.1, 5.2 and 5.5 of the SPS Agreement. It appears to the European Communities that there is no "sufficient basis" in the Panel Report for the Appellate Body to rule on the claims of the United States in respect of Article 2.2. Moreover, the United States bases its claims on certain paragraphs of the Panel Report that are founded on a manifest misunderstanding or clear distortion of the facts, or inadequate reasoning by the Panel, as explained by the European Communities in its own appeal.

80. The European Communities submits that, should the Appellate Body examine the applicability of Article 2.2 of the SPS Agreement, it should also examine the applicability of Article 5.7, which is expressly referred to in Article 2.2. The European Communities believes that its measures are consistent with Article 2.2 of the SPS Agreement.

81. The European Communities observes that in its appeal, the United States does not discuss what constitutes "sufficient" scientific evidence. Since the concepts of "risk" and "risk assessment" in the SPS Agreement are not quantitative, but qualitative concepts, the word "sufficient" also cannot be taken to

84. The European Communities has considered some possible alternatives to the prohibition of imports of bovine meat containing residues of hormones administered for growth promotion: first, the application of Maximum Residue Limits ("MRLs") to such meat; second, the application of some kind of control to all imports of meat to determine whether hormones had been administered for growth promotion purposes; and third, reliance on the exporters labelling their meat to indicate whether hormones had been administered for growth promotion purposes. According to the European Communities, however, none of the above alternative measures would achieve the specified level of protection.

G. Arguments by the Third Participants

1. Australia

85. Australia considers that the Panel erred in law in its general interpretations concerning the burden of proof under the SPS Agreement<sup>51</sup>, and supports the arguments put forward by the European Communities. However, it is also contended by Australia that paragraphs 8.54 and 8.58 of the Canada Panel Report and paragraphs 8.51 and 8.55 of the US Panel Report present correct interpretations of the burden of proof and that the Panel has, in general, followed these correct interpretations in its legal reasoning and findings.

86. The conclusion reached by the Panel with regard to the temporal application of the SPS Agreement is also supported by Australia. However, Australia also recognizes the concerns raised by the European Communities and agrees that there is nothing in the SPS Agreement that could be interpreted to mean that measures already in place at the time the SPS Agreement came into force are necessarily inconsistent simply because the "preparatory and procedural obligations" provided in Article 5 may not have been met. On the other hand, Australia admits that nothing in the SPS Agreement suggests that such measures can escape application of key provisions, such as Articles 5.1 and 5.2.

87. The Panel's interpretation that the SPS Agreement "equates" the terms "conform to" and "based on" ignores, in Australia's view, the ordinary meaning of these terms in their context and fails to give effect to all the terms of the SPS Agreement. The Panel has ignored the significant fact that the SPS Agreement uses the expression "conform to" in both Article 3.2 and Article 2.4, i.e. in the two situations where rebuttable presumptions are established that certain measures are consistent with the SPS Agreement and/or the GATT 1994. Australia believes that the issue of whether a particular measure is "based on"

an international standard, or "conforms to" such a standard, is something which can only be determined on a case-by-case basis.

88. The Panel failed to give effect to all the terms of the SPS Agreement by its treatment of the two options provided in Article 3.3. According to Australia, the Panel has ignored the differences in the wording of the two options, and their explicit identification as alternatives by the use of the word "or" in Article 3.3. This interpretation has resulted in the Panel concluding that both alternatives mean that a measure can only be justified under Article 3.3 if it meets the requirements of Article 5. In Australia's view, while a Member's determination under the first of these options must be "based on" an examination and evaluation of available scientific information "in conformity with" the relevant provisions of the SPS Agreement, there remains an important distinction between the two options which the Panel failed to recognize.

89. Australia also considers as erroneous the Panel's interpretation of "risk", specifically its use of the term "identifiable risk", which has no basis in the text of the SPS Agreement. What the Panel is required to examine under Articles 5.1 and 5.2 is whether the EC measure is "based on" a risk assessment, and not whether there was an "identifiable risk".

90. In discussing whether there is a need for a separate risk assessment for each individual substance, Australia draws particular attention to the wording of Article 5.1 providing for a risk assessment "as appropriate to the circumstances". This wording expressly recognizes that what constitutes an appropriate risk assessment may differ from case to case. In the view of Australia, the determination of whether a risk assessment is required for a particular individual substance should therefore be made on a case-by-case basis. The Panel recognized that in order to find an SPS measure inconsistent with Article 5.5 all elements of this provision need to be present<sup>52</sup> but the Panel, nevertheless, gave undue weight, in the view of Australia, to the significance of the distinction in the levels of protection. The Panel's reference to the Appellate Body Report in Japan - Alcoholic Beverages<sup>53</sup> concerning the requirements of Article III:2 of the GATT 1994 was misleading and inappropriate.

91. Although Australia supports the view of the United States that the EC measures are inconsistent with Article 2.2 of the SPS Agreement, Australia does not believe there was any need for the Panel to make such a finding.

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<sup>52</sup>US Panel Report, para. 8.174; Canada Panel Report, para. 8.177.

<sup>53</sup>Adopted 1 November 1996, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R.

2. New Zealand

92. New Zealand refers to its third party submission to the Panel relating to Articles 2.2 and 5.6. New Zealand submits that since the Panel found that there was no scientific evidence that indicated that an identifiable risk arises from the use of any of the hormones at issue when used for growth promotion purposes in accordance with good practice, the Appellate Body should consider the applicability of Articles 2.2 and 5.6 of the SPS Agreement to the import ban.

3. Norway

93. Norway stresses that the SPS Agreement does not contain obligations to harmonize different levels of protection. The right of every Member to set its own level of protection is, according to Norway, an inherent right that has always been accepted by the GATT and now by the WTO Agreement. In the view of Norway, Members have a variety of options when deciding on their appropriate level of protection. They may decide to adopt a more lenient approach or a more stringent approach. Member A may decide to have a (close to) zero tolerance for deaths related to the usage of certain substances, while Member B accepts one death per million per year. This is entirely for Member A and Member B to decide. When, thereafter, each Member chooses the measure necessary to achieve its level of protection, that measure must comply with the basic obligations of Articles 2, 3 and 5 of the SPS Agreement. As long as the existence of a risk is established, the WTO is only concerned with the justification of the measure the Member chooses to apply to achieve the level of protection it has deemed appropriate. According to Norway, there is no requirement on that Member to come to the same conclusions concerning the evaluation of the available scientific evidence that other Members or international organizations may have reached.

94. On the issue of burden of proof, Norway argues that the Panel erred when it described Article 3.1 as the general rule, thus imposing an obligation on Members to harmonize their SPS measures. Article 3.1 clearly states that harmonization is merely an objective or option, by using the words "... on as wide a basis as possible". The "exceptions" to this objective are not limited to situations covered by Article 3.3. There are others, as can be seen from the words "... except as otherwise provided for in this Agreement, and in particular in paragraph 3". Norway submits that instead of designating one paragraph of Article 3 as a general rule and others as exceptions, the Panel should have read Article 3 within the context of Articles 2.2 and 2.3. In the view of Norway, where the SPS measure is identical for domestic and imported products, the general rule -- as with all obligations -- is that the complainant must present a *prima facie* case of violation. The requirement in Article 2.2 that measures be "necessary" does not alter the above.

SPS measures are not exceptional measures, and the burden of proving that a measure is not necessary rests in the first instance with the complainant.

95. In respect of Article 5.5, Norway submits that it is the level of protection that is at issue, rather than the measure, which must "conform to" other parts of the SPS Agreement. It is for the complainant to prove that a decision on different levels of protection violates Article 5.5.

III. Issues Raised in this Appeal

96. This appeal raises the following legal issues:

- (a) Whether the Panel correctly allocated the burden of proof in this case;
- (b) Whether the Panel applied the appropriate standard of review under the SPS Agreement;
- (c) Whether, or to what extent, the precautionary principle is relevant in the interpretation of the SPS Agreement;
- (d) Whether the provisions of the SPS Agreement apply to measures enacted before the date of entry into force of the WTO Agreement;
- (e) Whether the Panel made an objective assessment of the facts pursuant to Article 11 of the DSU;
- (f) Whether the Panel acted within the scope of its authority in its selection and use of experts, in granting additional third party rights to the United States and Canada and in making findings based on arguments not made by the parties;
- (g) Whether the Panel correctly interpreted Articles 3.1 and 3.3 of the SPS Agreement;
- (h) Whether the EC measures are "based on" a risk assessment within the meaning of Article 5.1 of the SPS Agreement;

- (i) Whether the Panel correctly interpreted and applied Article 5.5 of the SPS Agreement; and
- (j) Whether the Panel appropriately exercised "judicial economy" in not making findings on the consistency of the EC measures with Article 2.2 and Article 5.6 of the SPS Agreement.

#### IV. Allocating the Burden of Proof in Proceedings Under the SPS Agreement

97. The first general issue that we must address relates to the allocation of the burden of proof in proceedings under the SPS Agreement. The Panel appropriately describes this issue as one "of particular importance"<sup>54</sup>, in view of the nature of disputes under that Agreement. Such disputes may raise multiple and complex issues of fact.

98. The Panel begins its analysis by setting out the general allocation of the burden of proof between the contending parties in any proceedings under the SPS Agreement. The initial burden lies on the complaining party, which must establish a prima facie case of inconsistency with a particular provision of the SPS Agreement on the part of the defending party, or more precisely, of its SPS measure or measures complained about. When that prima facie case is made, the burden of proof moves to the defending party, which must in turn counter or refute the claimed inconsistency. This seems straightforward enough and is in conformity with our ruling in *United States - Shirts and Blouses*<sup>55</sup>, which the Panel invokes and which embodies a rule applicable in any adversarial proceedings.

99. The Panel, however, proceeds to make a general, unqualified, interpretative ruling that the SPS Agreement allocates the "evidentiary burden" to the Member imposing an SPS measure. To support this general statement, which renders the Panel's reference to our own ruling in *United States - Shirts and Blouses* little more than lip-service, the Panel first points to:

... the wording of many of the provisions contained in [the SPS] Agreement and in particular the first three words thereof: "Members

shall ensure that ..." (e.g. Articles 2.2, 2.3, 5.1 and 5.6 of the SPS Agreement).<sup>56</sup>

100. The Panel next quotes Article 5.8 of the SPS Agreement, while parenthetically noting that this Article "relates more to transparency than to any requirement of legal justification".<sup>57</sup> Article 5.8 provides:

When a Member has reason to believe that a specific sanitary or phytosanitary measure introduced or maintained by another Member is constraining, or has the potential to constrain, its exports and the measure is not based on the relevant international standards, guidelines or recommendations, or such standards, guidelines or recommendations do not exist, an explanation of the reasons for such sanitary or phytosanitary measure may be requested and shall be provided by the Member maintaining the measure.

101. Lastly, the Panel seeks support for its general interpretative ruling in Article 3.2 of the SPS Agreement, which establishes a presumption of consistency with relevant provisions of that Agreement and of the GATT 1994 for measures that conform to international standards, guidelines and recommendations. From this presumption, the Panel extracts a reverse inference that if a measure does not conform to international standards, the Member imposing such a measure must bear the burden of proof in any complaint of inconsistency with a provision of the SPS Agreement.<sup>58</sup>

102. We find the general interpretative ruling of the Panel to be bereft of basis in the SPS Agreement and must, accordingly, reverse that ruling. It does not appear to us that there is any necessary (i.e. logical) or other connection between the undertaking of Members to ensure, for example, that SPS measures are "applied only to the extent necessary to protect human, animal or plant life or health ..."<sup>59</sup>, and the allocation of burden of proof in a dispute settlement proceeding. Article 5.8 of the SPS Agreement does not purport to address burden of proof problems; it does not deal with a dispute settlement situation. To the contrary, a Member seeking to exercise its right to receive information under Article 5.8 would, most likely, be in a pre-dispute situation, and the information or explanation it receives may well make it possible for that Member to proceed to dispute settlement proceedings and to carry the burden of proving on a prima facie basis that the measure involved is not consistent with the SPS Agreement. The Panel's last reason involves, quite simply, a non-sequitur. The converse or a *contra*rio presumption created by the Panel

<sup>56</sup>US Panel Report, para. 8.52; Canada Panel Report, para. 8.55.

<sup>57</sup>US Panel Report, para. 8.53; Canada Panel Report, para. 8.56.

<sup>58</sup>US Panel Report, para. 8.54; Canada Panel Report, para. 8.57.

<sup>59</sup>SPS Agreement, Article 2.2.

<sup>54</sup>US Panel Report, para. 8.48; Canada Panel Report, para. 8.51.

<sup>55</sup>Adopted 23 May 1997, WT/DS33/AB/R, p. 14.

does not arise. The presumption of consistency with relevant provisions of the SPS Agreement that arises under Article 3.2 in respect of measures that conform to international standards may well be an incentive for Members so to conform their SPS measures with such standards. It is clear, however, that a decision of a Member not to conform a particular measure with an international standard does not authorize imposition of a special or generalized burden of proof upon that Member, which may, more often than not, amount to a penalty.

103. In initiating its discussion on the requirements of Articles 3.1 and 3.3 of the SPS Agreement, the Panel turns once more to allocating the burden of proof between the complaining parties and the defending party. The Panel states:

One purpose of the SPS Agreement, as explicitly recognized in the preamble, is to promote the use of international standards, guidelines and recommendations. To that end, Article 3.1 imposes an obligation on all Members to base their sanitary measures on international standards except as otherwise provided for in the SPS Agreement, and in particular in Article 3.3 thereof. In this sense, Article 3.3 provides an exception to the general obligation contained in Article 3.1. Article 3.2, in turn, specifies that the complaining party has the burden of overcoming a presumption of consistency with the SPS Agreement in the case of a measure based on international standards. It thereby suggests by implication that when a measure is not so based, the burden is on the respondent to show that the measure is justified under the exceptions provided for in Article 3.3.

We find, therefore, that once the complaining party provides a prima facie case (i) that there is an international standard with respect to the measure in dispute, and (ii) that the measure in dispute is not based on this standard, the burden of proof under Article 3.3 shifts to the defending party.<sup>60</sup> (underlining added)

104. The Panel relies on two interpretative points in reaching its above finding. First, the Panel posits the existence of a "general rule - exception" relationship between Article 3.1 (the general obligation) and Article 3.3 (an exception)<sup>61</sup> and applies to the SPS Agreement what it calls "established practice under GATT 1947 and GATT 1994" to the effect that the burden of justifying a measure under Article XX of the GATT 1994 rests on the defending party.<sup>62</sup> It appears to us that the Panel has misconceived the

relationship between Articles 3.1, 3.2 and 3.3, a relationship discussed below<sup>63</sup>, which is qualitatively different from the relationship between, for instance, Articles I or III and Article XX of the GATT 1994. Article 3.1 of the SPS Agreement simply excludes from its scope of application the kinds of situations covered by Article 3.3 of that Agreement, that is, where a Member has projected for itself a higher level of sanitary protection than would be achieved by a measure based on an international standard. Article 3.3 recognizes the autonomous right of a Member to establish such higher level of protection, provided that that Member complies with certain requirements in promulgating SPS measures to achieve that level. The general rule in a dispute settlement proceeding requiring a complaining party to establish a prima facie case of inconsistency with a provision of the SPS Agreement before the burden of showing consistency with that provision is taken on by the defending party, is not avoided by simply describing that same provision as an "exception". In much the same way, merely characterizing a treaty provision as an "exception" does not by itself justify a "stricter" or "narrower" interpretation of that provision than would be warranted by examination of the ordinary meaning of the actual treaty words, viewed in context and in the light of the treaty's object and purpose, or, in other words, by applying the normal rules of treaty interpretation. It is also well to remember that a prima facie case is one which, in the absence of effective refutation by the defending party, requires a panel, as a matter of law, to rule in favour of the complaining party presenting the prima facie case.<sup>64</sup>

105. Secondly, the Panel relies upon the reverse presumption or implication it discovered in Article 3.2 of the SPS Agreement. As already noted, we have been unable to find any basis for that implication or presumption.<sup>65</sup>

106. We believe, therefore, and so hold that the Panel erred in law both in its two interpretative points and its finding set out in paragraphs 8.86 and 8.87 of the US Panel Report and paragraphs 8.89 and 8.90 of the Canada Panel Report (quoted above).<sup>66</sup>

107. The legal interpretations developed and the findings set out above by the Panel appear to have been applied, *inter alia*, in the following paragraphs that have also been appealed by the European Communities:

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<sup>63</sup>Paras. 169-172 of this Report.

<sup>64</sup>Appellate Body Report, United States - Shirts and Blouses, adopted 23 May 1997, WT/DS33/AB/R, p. 14.

<sup>65</sup>Para. 102 of this Report.

<sup>66</sup>See para. 103 of this Report.

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<sup>60</sup>US Panel Report, paras. 8.86 and 8.87; Canada Panel Report, paras. 8.89 and 8.90.

<sup>61</sup>US Panel Report, para. 8.86; Canada Panel Report, para. 8.89.

<sup>62</sup>US Panel Report, footnote 288; Canada Panel Report, footnote 393.

We recall the conclusions we reached above on burden of proof, in particular that the European Communities has, with respect to its measures which deviate from international standards, the burden of proving the existence of a risk assessment (and, derived therefrom, an identifiable risk) on which the EC measures in dispute are based. It is not, in this dispute, for the United States to prove that there is no risk.<sup>67</sup>

We finally recall our findings reached above on the specific burden of proof under Article 3.3. In particular, we found that the burden of proving that the requirements imposed by Article 3.3 (inter alia, consistency with Article 5) are met, in order to justify a sanitary measure which deviates from an international standard, rests with the Member imposing that measure. Since the EC measures examined in this section (relating to all hormones in dispute other than MGA) are not based on existing international standards and need to be justified under the exceptions provided for in Article 3.3, the European Communities bears the burden of proving that the determination and application of its level of protection is consistent with Articles 5.4 to 5.6.<sup>68</sup>

108. To the extent that the Panel<sup>69</sup> purports to absolve the United States and Canada from the necessity of establishing a prima facie case showing the absence of the risk assessment required by Article 5.1, and the failure of the European Communities to comply with the requirements of Article 3.3, and to impose upon the European Communities the burden of proving the existence of such risk assessment and the consistency of its measures with Articles 5.4, 5.5 and 5.6 without regard to whether or not the complaining parties had already established their prima facie case, we consider and so hold that the Panel once more erred in law.

109. In accordance with our ruling in United States - Shirts and Blouses<sup>70</sup>, the Panel should have begun the analysis of each legal provision by examining whether the United States and Canada had presented evidence and legal arguments sufficient to demonstrate that the EC measures were inconsistent with the obligations assumed by the European Communities under each Article of the SPS Agreement addressed by the Panel, i.e., Articles 3.1, 3.3, 5.1 and 5.5. Only after such a prima facie determination had been

<sup>67</sup>US Panel Report, para. 8.151; Canada Panel Report, para. 8.154.

<sup>68</sup>US Panel Report, para. 8.165; Canada Panel Report, para. 8.168.

<sup>69</sup>US Panel Report, paras. 8.151 and 8.165; Canada Panel Report, paras. 8.154 and 8.168.

<sup>70</sup>Adopted 23 May 1997, WT/DS33/AB/R, pp. 14-16.

made by the Panel may the onus be shifted to the European Communities to bring forward evidence and arguments to disprove the complaining party's claim.<sup>71</sup>

V. The Standard of Review Applicable in Proceedings Under the SPS Agreement

110. The European Communities appeals from certain findings of the Panel<sup>72</sup> upon the ground that the Panel failed to apply an appropriate standard of review in assessing certain acts of, and scientific evidentiary material submitted by, the European Communities.<sup>73</sup> The European Communities claimed, more specifically, that:

... the panel erred in law in not according deference to the following elements of the EC measures:

- the EC's decision to set and apply a level of sanitary protection higher than that recommended by Codex Alimentarius for the risks arising from the use of these hormones for growth promotion;
- the EC's scientific assessment and management of the risk from the hormones at issue; and
- the EC's adherence to the precautionary principle and its aversion to accepting any increased carcinogenic risk.

The panel also erred in law because it:

- assigned a high probative value to the scientific views presented by some of the five scientific experts chosen by it (and to the views of the technical expert appointed by Codex Alimentarius);
- disregarded in effect or distorted the scientific evidence presented by the EC and its scientific advisors, and systematically considered the scientific views of the panel-appointed experts or even a minority of those experts, of higher probative value than the scientific evidence presented by the EC scientists;

<sup>71</sup>Our finding that the Panel erred in allocating the burden of proof generally to the Member imposing the measure, however, does not deal with the quite separate issue of whether the United States and Canada actually made a prima facie case of violation of each of the following Articles of the SPS Agreement: 3.1, 3.3, 5.1 and 5.5. See in this respect, footnote 180 of this Report.

<sup>72</sup>US Panel Report, paras. 8.124, 8.127, 8.133, 8.134, 8.145, 8.146, 8.194, 8.199, 8.213 and 8.255; Canada Panel Report, paras. 8.127, 8.130, 8.136, 8.137, 8.148, 8.149, 8.197, 8.202, 8.216 and 8.258.

<sup>73</sup>EC's appellant's submission, para. 140.

- based its legal interpretations and findings on a number of critical issues on the majority of scientific views presented by its own appointed experts, instead of limiting itself to examining whether the scientific evidence presented by the EC was based on "scientific principles" (as required by Article 2.2 [of the SPS Agreement]).<sup>74</sup>

111. In the view of the European Communities, the principal alternative approaches to the problem of formulating the "proper standard of review" so far as panels are concerned are two-fold. The first is designated as "de novo review". This standard of review would allow a panel complete freedom to come to a different view than the competent authority of the Member whose act or determination is being reviewed. A panel would have to "verify whether the determination by the national authority was correct both factually and procedurally".<sup>75</sup> The second is described as "deference". Under a "deference" standard, a panel, in the submission of the European Communities, should not seek to redo the investigation conducted by the national authority but instead examine whether the "procedure" required by the relevant WTO rules had been followed.<sup>76</sup>

112. Clearly referring only to an appropriate standard of review of factual determinations by the domestic authorities of a Member, the European Communities submits that the principle of deference has been embodied in Article 17.6(i) of the Anti-Dumping Agreement, which reads as follows:

17.6 In examining the matter referred to in paragraph 5:

- (i) in its assessment of the facts of the matter, the panel shall determine whether the authorities' establishment of the facts was proper and whether their evaluation of those facts was unbiased and objective. If the establishment of the facts was proper and the evaluation was unbiased and objective, even though the panel might have reached a different conclusion, the evaluation shall not be overturned;

113. The European Communities further urges that the above-quoted standard, which it describes as a "deferential reasonableness standard"<sup>77</sup> is applicable in "all highly complex factual situations,

<sup>74</sup>EC's appellant's submission, para. 139.

<sup>75</sup>EC's appellant's submission, para. 122.

<sup>76</sup>EC's appellant's submission, para. 123.

<sup>77</sup>EC's appellant's submission, para. 128.

including the assessment of the risks to human health arising from toxins and contaminants"<sup>78</sup>, and should have been applied by the Panel in the present case.

114. The first point that must be made in this connection, is that the SPS Agreement itself is silent on the matter of an appropriate standard of review for panels deciding upon SPS measures of a Member. Nor are there provisions in the DSU or any of the covered agreements (other than the Anti-Dumping Agreement) prescribing a particular standard of review. Only Article 17.6(i) of the Anti-Dumping Agreement has language on the standard of review to be employed by panels engaged in the "assessment of the facts of the matter". We find no indication in the SPS Agreement of an intent on the part of the Members to adopt or incorporate into that Agreement the standard set out in Article 17.6(i) of the Anti-Dumping Agreement. Textually, Article 17.6(i) is specific to the Anti-Dumping Agreement.<sup>79</sup>

115. The standard of review appropriately applicable in proceedings under the SPS Agreement, of course, must reflect the balance established in that Agreement between the jurisdictional competences conceded by the Members to the WTO and the jurisdictional competences retained by the Members for themselves.<sup>80</sup> To adopt a standard of review not clearly rooted in the text of the SPS Agreement itself, may well amount to changing that finely drawn balance; and neither a panel nor the Appellate Body is authorized to do that.

116. We do not mean, however, to suggest that there is at present no standard of review applicable to the determination and assessment of the facts in proceedings under the SPS Agreement or under other covered agreements. In our view, Article 11 of the DSU bears directly on this matter and, in effect,

<sup>78</sup>EC's appellant's submission, para. 127.

<sup>79</sup>On the other hand, as suggested by the United States, we must note the Decision on the Review of Article 17.6 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994, which states:

Ministers,

Decide as follows:

The standard of review in paragraph 6 of Article 17 of the Agreement on Implementation of Article VI of GATT 1994 shall be reviewed after a period of three years with a view to considering the question of whether it is capable of general application. (underlining added)

This Ministerial Decision evidences that the Ministers were aware that Article 17.6 of the Anti-Dumping Agreement was applicable only in respect of that Agreement.

<sup>80</sup>See, for example, S.P. Croley and J.H. Jackson, "WTO Dispute Panel Deference to National Government Decisions. The Misplaced Analogy to the U.S. Chevron Standard-of-Review Doctrine", in E.-U. Petersmann (ed.), *International Trade Law and the GATT/WTO Dispute Settlement System* (Kluwer, 1997) 185, p. 189; P.A. Akakwam, "The Standard of Review in the 1994 Antidumping Code: Circumscribing the Role of GATT Panels in Reviewing National Antidumping Determinations" (1996), 5:2 *Minnesota Journal of Global Trade* 277, pp. 295-296.

articulates with great succinctness but with sufficient clarity the appropriate standard of review for panels in respect of both the ascertainment of facts and the legal characterization of such facts under the relevant agreements. Article 11 reads thus:

The function of panels is to assist the DSB in discharging its responsibilities under this Understanding and the covered agreements. Accordingly, a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided in the covered agreements. Panels should consult regularly with the parties to the dispute and give them adequate opportunity to develop a mutually satisfactory solution". (underlining added)

117. So far as fact-finding by panels is concerned, their activities are always constrained by the mandate of Article 11 of the DSU: the applicable standard is neither de novo review as such, nor "total deference", but rather the "objective assessment of the facts". Many panels have in the past refused to undertake de novo review<sup>81</sup>, wisely, since under current practice and systems, they are in any case poorly suited to engage in such a review. On the other hand, "total deference to the findings of the national authorities", it has been well said, "could not ensure an 'objective assessment' as foreseen by Article 11 of the DSU".<sup>82</sup>

118. In so far as legal questions are concerned - that is, consistency or inconsistency of a Member's measure with the provisions of the applicable agreement - a standard not found in the text of the SPS Agreement itself cannot absolve a panel (or the Appellate Body) from the duty to apply the customary rules of interpretation of public international law.<sup>83</sup> It may be noted that the European Communities refrained from suggesting that Article 17.6 of the Anti-Dumping Agreement in its entirety was applicable to the present case. Nevertheless, it is appropriate to stress that here again Article 11 of the DSU is directly on point, requiring a panel to "make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements ...".

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<sup>81</sup> Panel Report, United States - Underwear, adopted 25 February 1997, WT/DS24/R; Panel Report, Korea - Anti-Dumping Duties on Imports of Polyacetal Resins from the United States, adopted 27 April 1993, BISD 40S/205; Panel Report, United States - Imposition of Anti-Dumping Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway, adopted 27 April 1994, ADP/87; and Panel Report, United States - Initiation of a Countervailing Duty Investigation into Softwood Lumber Products from Canada, adopted 3 June 1987, BISD 34S/194.

<sup>82</sup> Panel Report, United States - Underwear, adopted 25 February 1997, WT/DS24/R, para. 7.10

<sup>83</sup> DSU, Article 3.2.

119. We consider, therefore, that the issue of failure to apply an appropriate standard of review, raised by the European Communities, resolves itself into the issue of whether or not the Panel, in making the above and other findings referred to and appealed by the European Communities, had made an "objective assessment of the matter before it, including an objective assessment of the facts ...". This particular issue is addressed (in substantial detail) below.<sup>84</sup> Here, however, we uphold the findings of the Panel appealed by the European Communities upon the ground of failure to apply either a "deferential reasonableness standard" or the standard of review set out in Article 17.6(i) of the Anti-Dumping Agreement.

VI. The Relevance of the Precautionary Principle in the Interpretation of the SPS Agreement

120. We are asked by the European Communities to reverse the finding of the Panel relating to the precautionary principle. The Panel's finding and its supporting statements are set out in the Panel Reports in the following terms:

The European Communities also invokes the precautionary principle in support of its claim that its measures in dispute are based on a risk assessment. To the extent that this principle could be considered as part of customary international law and be used to interpret Articles 5.1 and 5.2 on the assessment of risks as a customary rule of interpretation of public international law (as that phrase is used in Article 3.2 of the DSU), we consider that this principle would not override the explicit wording of Articles 5.1 and 5.2 outlined above, in particular since the precautionary principle has been incorporated and given a specific meaning in Article 5.7 of the SPS Agreement. We note, however, that the European Communities has explicitly stated in this case that it is not invoking Article 5.7.

We thus find that the precautionary principle cannot override our findings made above, namely that the EC import ban of meat and meat products from animals treated with any of the five hormones at issue for growth promotion purposes, in so far as it also applies to meat and meat products from animals treated with any of these hormones in accordance with good practice, is, from a substantive point of view, not based on a risk assessment.<sup>85</sup> (underlining added)

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<sup>84</sup> Paras. 131-144 of this Report.

<sup>85</sup> US Panel Report, paras. 8.157 and 8.158; Canada Panel Report, paras. 8.160 and 8.161.

Body in this appeal to take a position on this important, but abstract, question. We note that the Panel itself did not make any definitive finding with regard to the status of the precautionary principle in international law and that the precautionary principle, at least outside the field of international environmental law, still awaits authoritative formulation.<sup>93</sup>

124. It appears to us important, nevertheless, to note some aspects of the relationship of the precautionary principle to the SPS Agreement. First, the principle has not been written into the SPS Agreement as a ground for justifying SPS measures that are otherwise inconsistent with the obligations of Members set out in particular provisions of that Agreement. Secondly, the precautionary principle indeed finds reflection in Article 5.7 of the SPS Agreement. We agree, at the same time, with the European Communities, that there is no need to assume that Article 5.7 exhausts the relevance of a precautionary principle. It is reflected also in the sixth paragraph of the preamble and in Article 3.3. These explicitly recognize the right of Members to establish their own appropriate level of sanitary protection, which level may be higher (i.e., more cautious) than that implied in existing international standards, guidelines and recommendations. Thirdly, a panel charged with determining, for instance, whether "sufficient scientific evidence" exists to warrant the maintenance by a Member of a particular SPS measure may, of course, and should, bear in mind that responsible, representative governments commonly act from perspectives of prudence and precaution where risks of irreversible, e.g. life-terminating, damage to human health are concerned. Lastly, however, the precautionary principle does not, by itself, and without a clear textual directive to that effect, relieve a panel from the duty of applying the normal (i.e. customary international law) principles of treaty interpretation in reading the provisions of the SPS Agreement.

125. We accordingly agree with the finding of the Panel that the precautionary principle does not override the provisions of Articles 5.1 and 5.2 of the SPS Agreement.

121. The basic submission of the European Communities is that the precautionary principle is, or has become, "a general customary rule of international law" or at least "a general principle of law".<sup>86</sup> Referring more specifically to Articles 5.1 and 5.2 of the SPS Agreement, applying the precautionary principle means, in the view of the European Communities, that it is not necessary for all scientists around the world to agree on the "possibility and magnitude" of the risk, nor for all or most of the WTO Members to perceive and evaluate the risk in the same way.<sup>87</sup> It is also stressed that Articles 5.1 and 5.2 do not prescribe a particular type of risk assessment and do not prevent Members from being cautious in their risk assessment exercise.<sup>88</sup> The European Communities goes on to state that its measures here at stake were precautionary in nature and satisfied the requirements of Articles 2.2 and 2.3, as well as of Articles 5.1, 5.2, 5.4, 5.5 and 5.6 of the SPS Agreement.<sup>89</sup>

122. The United States does not consider that the "precautionary principle" represents customary international law and suggests it is more an "approach" than a "principle".<sup>90</sup> Canada, too, takes the view that the precautionary principle has not yet been incorporated into the corpus of public international law; however, it concedes that the "precautionary approach" or "concept" is "an emerging principle of law" which may in the future crystallize into one of the "general principles of law recognized by civilized nations" within the meaning of Article 38(1)(c) of the Statute of the International Court of Justice.<sup>91</sup>

123. The status of the precautionary principle in international law continues to be the subject of debate among academics, law practitioners, regulators and judges. The precautionary principle is regarded by some as having crystallized into a general principle of customary international environmental law. Whether it has been widely accepted by Members as a principle of general or customary international law appears less than clear.<sup>92</sup> We consider, however, that it is unnecessary, and probably imprudent, for the Appellate

<sup>86</sup>EC's appellant's submission, para. 91.

<sup>87</sup>EC's appellant's submission, para. 88.

<sup>88</sup>EC's appellant's submission, para. 94.

<sup>89</sup>EC's appellant's submission, para. 98.

<sup>90</sup>United States' appellee's submission, para. 92.

<sup>91</sup>Canada's appellee's submission, para. 34.

<sup>92</sup>Authors like P. Sands, J. Cameron and J. Abouchar, while recognizing that the principle is still evolving, submit nevertheless that there is currently sufficient state practice to support the view that the precautionary principle is a principle of customary international law. See, for example, P. Sands, *Principles of International Environmental Law*, Vol. 1 (Manchester University Press 1995) p. 212; J. Cameron, "The Status of the Precautionary Principle in International Law", in J. Cameron and T. O'Riordan (eds.), *Interpreting the Precautionary Principle* (Cameron May, 1994) 262, p. 283; J. Cameron and J. Abouchar, "The Status of the Precautionary Principle in International Law", in D. Freestone and E. Hey (eds.), *The Precautionary Principle in International Law* (Kluwer, 1996) 29, p. 52. Other authors argue that the precautionary principle has not yet reached the status of a principle of international law, or at least, consider such status doubtful, among other reasons, due to the fact that the principle is still subject to a great variety of interpretations. See, for example, P. Birnie and A. Boyle, *International Law and the Environment* (Clarendon Press, 1992), p. 98; L. Gündling, "The Status in International Law of the Precautionary Principle" (1990), 5:1.2.3

*International Journal of Estuarine and Coastal Law* 25, p. 30; A. deMestral (et. al), *International Law Chiefly as Interpreted and Applied in Canada*, 5th ed. (Emond Montgomery, 1993), p. 765; D. Bodansky, in *Proceedings of the 85th Annual Meeting of the American Society of International Law (ASIL)*, 1991, p. 415.

<sup>93</sup>In *Case Concerning the Gabčíkovo-Nagymaros Project* (Hungary/Slovakia), the International Court of Justice recognized that in the field of environmental protection "... new norms and standards have been developed, set forth in a great number of instruments during the last two decades. Such new norms have to be taken into consideration, and such new standards given proper weight. ..." However, we note that the Court did not identify the precautionary principle as one of those recently developed norms. It also declined to declare that such principle could override the obligations of the Treaty between Czechoslovakia and Hungary of 16 September 1977 concerning the construction and operation of the Gabčíkovo/Nagymaros System of Locks. See, *Case Concerning the Gabčíkovo-Nagymaros Project* (Hungary/Slovakia), I.C.J. Judgement, 25 September 1997, paras. 140, 111-114. Not yet reported in the I.C.J. Reports but available on internet at <http://www.icj-cij.org/idecis.htm>.

be assumed that central provisions of the SPS Agreement, such as Articles 5.1 and 5.5, do not apply to measures which were enacted before 1995 but which continue to be in force thereafter. If the negotiators had wanted to exempt the very large group of SPS measures in existence on 1 January 1995 from the disciplines of provisions as important as Articles 5.1 and 5.5, it appears reasonable to us to expect that they would have said so explicitly. Articles 5.1 and 5.5 do not distinguish between SPS measures adopted before 1 January 1995 and measures adopted since; the relevant implication is that they are intended to be applicable to both. Furthermore, other provisions of the SPS Agreement, such as Articles 2.2, 2.3, 3.3 and 5.6, expressly contemplate applicability to SPS measures that already existed on 1 January 1995. Finally, we observe, more generally, that Article XVI.4 of the WTO Agreement stipulates that:

Each Member shall ensure the conformity of its laws, regulations and administrative procedures with its obligations as provided in the annexed Agreements.

Unlike the GATT 1947, the WTO Agreement was accepted definitively by Members, and therefore, there are no longer "existing legislation" exceptions (so-called "grandfather rights").<sup>100</sup>

129. We are aware that the applicability, as from 1 January 1995, of the requirement that an SPS measure be based on a risk assessment to the many SPS measures already in existence on that date, may impose burdens on Members. It is pertinent here to note that Article 5.1 stipulates that SPS measures must be based on a risk assessment, as appropriate to the circumstances, and this makes clear that the Members have a certain degree of flexibility in meeting the requirements of Article 5.1.

130. We therefore affirm the finding of the Panel with regard to the temporal application of the SPS Agreement. We also note that the measure at issue in this appeal is, since 1 July 1997, no longer embodied in the pre-1995 Directives referred to above, but rather in Directive 96/22, which was elaborated and enacted after the entry into force of the WTO Agreement. None of the parties contests that the currently applicable measure is subject to the disciplines of Articles 5.1 and 5.5 of the SPS Agreement.

VIII. The Requirement of Objective Assessment of the Facts by a Panel Under Article 11 of the DSU

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into force of the WTO Agreement and SPS measures enacted since.

<sup>100</sup>With the exception of the measures taken by a Member under specific mandatory legislation referred to in paragraph 3(a) of the language incorporating the GATT 1994 into the WTO Agreement.

VII. Application of the SPS Agreement to Measures Enacted Before 1 January 1995

126. Although Directives 81/602, 88/148 and 88/299 were enacted before the entry into force of the WTO Agreement on 1 January 1995, the Panel held<sup>94</sup> that, in line with Article 28 of the Vienna Convention on the Law of Treaties (the "Vienna Convention")<sup>95</sup>, the SPS Agreement should apply to the EC measures at issue because they continued to exist after 1 January 1995 and the SPS Agreement does not show any intention to limit its application to measures enacted after the entry into force of the WTO Agreement. The Panel stated that, to the contrary, several provisions of the SPS Agreement, and in particular Articles 2.2, 3.3, 5.6, 5.8 and 14 thereof, confirm the SPS Agreement does indeed apply to SPS measures which were enacted before 1 January 1995 but were maintained thereafter.<sup>96</sup>

127. The European Communities submits that this conclusion of the Panel is "too sweeping"<sup>97</sup> and that the SPS Agreement shows an intention to limit the temporal application of the Agreement, and in particular Articles 5.1 to 5.5 thereof, to measures enacted after the entry into force of the Agreement.

128. We addressed the issue of temporal application in our Report in Brazil - Measures Affecting Desiccated Coconut and concluded on the basis of Article 28 of the Vienna Convention that:

Absent a contrary intention, a treaty cannot apply to acts or facts which took place, or situations which ceased to exist, before the date of its entry into force.<sup>98</sup>

We agree with the Panel that the SPS Agreement would apply to situations or measures that did not cease to exist, such as the 1981 and 1988 Directives, unless the SPS Agreement reveals a contrary intention. We also agree with the Panel that the SPS Agreement does not reveal such an intention. The SPS Agreement does not contain any provision limiting the temporal application of the SPS Agreement, or of any provision thereof, to SPS measures adopted after 1 January 1995.<sup>99</sup> In the absence of such a provision, it cannot

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<sup>94</sup>US Panel Report, para. 8.25; Canada Panel Report, para. 8.28.

<sup>95</sup>Done at Vienna, 23 May 1969, 1155 UNTS 331; (1969), 8 International Legal Materials, 679.

<sup>96</sup>US Panel Report, para. 8.26; Canada Panel Report, para. 8.29.

<sup>97</sup>EC's appellant's submission, para. 264.

<sup>98</sup>Adopted 20 March 1997, WT/DS22/AB/R, p. 15.

<sup>99</sup>Note that Article 14 of the SPS Agreement allows the least-developed country Members and other developing country Members to delay implementation of the provisions of that Agreement for a period of five and two years, respectively, following the date of entry into force of the WTO Agreement. Developing country Members may only delay application of the provisions of that Agreement where such application is prevented by lack of technical expertise, technical infrastructure or resources. This right to defer application of the provisions of the SPS Agreement concerns, however, both SPS measures existing before the entry

131. The European Communities claims that the Panel has disregarded or distorted the evidence submitted by the European Communities to the Panel, as well as the opinions and statements made by the scientific experts advising the Panel. It is claimed, in other words, that the Panel has failed to make an objective assessment of the facts as required by Article 11 of the DSU, and the European Communities asks us to reverse the findings so arrived at by the Panel.

132. Under Article 17.6 of the DSU, appellate review is limited to appeals on questions of law covered in a panel report and legal interpretations developed by the panel. Findings of fact, as distinguished from legal interpretations or legal conclusions, by a panel are, in principle, not subject to review by the Appellate Body. The determination of whether or not a certain event did occur in time and space is typically a question of fact; for example, the question of whether or not Codex has adopted an international standard, guideline or recommendation on MGA is a factual question. Determination of the credibility and weight properly to be ascribed to (that is, the appreciation of) a given piece of evidence is part and parcel of the fact finding process and is, in principle, left to the discretion of a panel as the trier of facts. The consistency or inconsistency of a given fact or set of facts with the requirements of a given treaty provision is, however, a legal characterization issue. It is a legal question. Whether or not a panel has made an objective assessment of the facts before it, as required by Article 11 of the DSU, is also a legal question which, if properly raised on appeal, would fall within the scope of appellate review.

133. The question which then arises is this: when may a panel be regarded as having failed to discharge its duty under Article 11 of the DSU to make an objective assessment of the facts before it? Clearly, not every error in the appreciation of the evidence (although it may give rise to a question of law) may be characterized as a failure to make an objective assessment of the facts. In the present appeal, the European Communities repeatedly claims that the Panel disregarded or distorted or misrepresented the evidence submitted by the European Communities and even the opinions expressed by the Panel's own expert advisors. The duty to make an objective assessment of the facts is, among other things, an obligation to consider the evidence presented to a panel and to make factual findings on the basis of that evidence. The deliberate disregard of, or refusal to consider, the evidence submitted to a panel is incompatible with a panel's duty to make an objective assessment of the facts. The wilful distortion or misrepresentation of the evidence put before a panel is similarly inconsistent with an objective assessment of the facts. "Disregard" and "distortion" and "misrepresentation" of the evidence, in their ordinary significance in judicial and quasi-judicial processes, imply not simply an error of judgment in the appreciation of evidence

but rather an egregious error that calls into question the good faith of a panel.<sup>101</sup> A claim that a panel disregarded or distorted the evidence submitted to it is, in effect, a claim that the panel, to a greater or lesser degree, denied the party submitting the evidence fundamental fairness, or what in many jurisdictions is known as due process of law or natural justice.

134. It is, accordingly, incumbent upon us to examine the claims of the European Communities that the Panel here disregarded or distorted at least some of the evidence submitted to it.

#### A. Evidence with Regard to MGA

135. According to the European Communities, the Panel's finding that the experts advising the Panel have stated on several occasions that they are not aware of any publicly available scientific studies that evaluate the safety of MGA<sup>102</sup> is manifestly not true.<sup>103</sup> The Panel cited only two of its experts (Dr. Ritter and Dr. McLean) and the statements of these two scientists do not entirely support the Panel's conclusion. Furthermore, the Panel did not mention that Dr. André and Dr. Lucier, two other experts advising the Panel, had respectively said that MGA is a "real risk" and that MGA is an "extraordinarily potent progestant", that is "about 30 times more potent than progesterone and orally active".<sup>104</sup> We note that Dr. Ritter clearly stated with regard to MGA that he had "no information other than of a proprietary nature which [he] did not use"<sup>105</sup> and that Dr. McLean stated he had made no comment in his submission about MGA "because there hasn't been a large amount of data package available".<sup>106</sup> These two statements tend to support the Panel's conclusion. It is true that the Panel does not refer to the statements by Dr. Lucier and Dr. André. However, these statements do not contradict the Panel's conclusion that there is no publicly available study on the safety of MGA. Furthermore, while the Panel could have made a reference to and an evaluation of the statements by Dr. André and Dr. Lucier concerning MGA, it is generally within the discretion of the Panel to decide which evidence it chooses to utilize in making findings. We do not think that the Panel's silence on the statements of Dr. André and Dr. Lucier constitutes a distortion or disregard of evidence.

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<sup>101</sup>It might be asked whether the European Communities did not merely intend to use "disregard" and "distortion" as unusually forceful synonyms for "misapprehend" or "misappreciation". It is not, however, clear that the European Communities did so intend, considering among other things the marked frequency with which "disregard" and "distortion" were used.

<sup>102</sup>US Panel Report, para. 8.255; Canada Panel Report, para. 8.258.

<sup>103</sup>EC's appellant's submission, para. 168.

<sup>104</sup>EC's appellant's submission, para. 170, quoting Annex to the US and Canada Panel Reports, para. 852.

<sup>105</sup>Annex to the US and Canada Panel Reports, para. 352.

<sup>106</sup>Annex to the US and Canada Panel Reports, para. 354.

explicitly. The same thing may be said with regard to the claim by the European Communities that the Panel failed to quote certain statements by Dr. Ritter and Dr. McLean.<sup>111</sup>

139. Second, it is claimed that the Panel manifestly distorted the views of Dr. André when it said that he did not contest the statements made by the other Panel experts on the safety of the hormones in dispute.<sup>112</sup> To the contrary, according to the European Communities, the views expressed by Dr. André support the scientific opinions presented by the EC scientists.<sup>113</sup> Whether or not the views of Dr. André support the statements made by the other Panel experts or the opinions expressed by the EC scientists may be an issue of fact; it does require some technical expertise to deal with it. However, even if the Panel has interpreted the views of Dr. André incorrectly, we see no reason, and no reason was advanced, to consider this mistake as a deliberate disregard or distortion of evidence.

140. Third, it is claimed that the Panel manifestly distorted the scientific evidence by considering that the 1995 EC Scientific Conference amounted to a risk assessment in the sense of Articles 5.1-5.2. However, we note that the Panel does not state that the 1995 EC Conference amounted to a risk assessment. The Panel includes this Conference in the listing of scientific evidence concerning the hormones at issue referred to by the European Communities.<sup>114</sup> With regard to the reports mentioned in this list, the Panel states that several of these reports appear to meet the minimum requirements of a risk assessment, referring to the Laming Report and the 1988 and 1989 JECFA Reports.<sup>115</sup> The Panel does not, however, refer to the 1995 EC Conference. The Panel discusses the scientific conclusions to be drawn from the 1995 EC Scientific Conference but this does not amount to designating the Conference as a risk assessment.<sup>116</sup>

141. Fourth, the European Communities contends that the distinction made by the Panel between studies that generally relate to the hormones in dispute and studies that specifically address residues in food of these hormones when used for growth promotion purposes is a distinction devised by the Panel for the sole purpose of rejecting the relevance of the 1987 IARC Monographs in this case and amounts to a

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<sup>111</sup>See the statements of Dr. Ritter in paras. 322, 743 and 782, and the statement of Dr. McLean in para. 824, of the Annex to the US and Canada Panel Reports.

<sup>112</sup>See footnote 348 of the US Panel Report and footnote 455 of the Canada Panel Report.

<sup>113</sup>See, in particular, paras. 6.99 to 6.101 of the US Panel Report and paras. 6.98 to 6.100 of the Canada Panel Report.

<sup>114</sup>US Panel Report, para. 8.108; Canada Panel Report, para. 8.111. The 1995 EC Conference Proceedings were submitted by the European Communities itself as annexes to its first submission to the Panel in both the US and Canada proceedings.

<sup>115</sup>US Panel Report, para. 8.111; Canada Panel Report, para. 8.114.

<sup>116</sup>US Panel Report, para. 8.123; Canada Panel Report, para. 8.126.

136. The European Communities argues that the Panel failed to request the submission of data on MGA and contends that this failure constituted a violation of Article 11 of the DSU. However, we see nothing in Article 11 to suggest that there is an obligation on the Panel to gather data relating to MGA and that it was therefore required to request the submission of this data.

137. Furthermore, the European Communities states that the Panel arbitrarily disregarded all the information concerning MGA that the European Communities had supplied to the Panel. The information here referred to are studies and reports of the IARC on hormones, including progestins, a category of substances to which MGA is said to belong. However, we note that the Panel did not simply ignore the IARC studies and reports but rather had indicated it did not consider them to be relevant because it found that a risk assessment needs to be carried out for each individual substance.<sup>107</sup>

#### B. Evidence with Regard to the Five Other Hormones

138. With regard to the five other hormones in dispute, the European Communities contends that the Panel manifestly distorted the scientific evidence presented by the European Communities and eliminated dissenting scientific views of its own experts in an attempt to make the desired result fit the scientific record.<sup>108</sup> First, the European Communities submits<sup>109</sup> that the Panel incorrectly quotes some of the statements of Dr. Lucier and totally ignores other more relevant statements he made.<sup>110</sup> We note that the Panel did indeed quote Dr. Lucier incorrectly. The Panel wrongly interpreted Dr. Lucier's statement in paragraph 819 of the Annex as meaning that the 0 to 1 in a million risk is caused by the total amount of oestrogens in treated meat. It is clear that Dr. Lucier stated that this risk is caused by the small fraction of oestrogens that is added for growth promotion purposes. However, this mistake on the part of the Panel in interpreting Dr. Lucier's statement does not constitute a deliberate disregard of evidence or gross negligence amounting to bad faith. The Panel also failed to refer to certain other statements made by Dr. Lucier. It seems to us that these statements either merely clarify the statement discussed above or are of a general nature. The Panel cannot realistically refer to all statements made by the experts advising it and should be allowed a substantial margin of discretion as to which statements are useful to refer to

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<sup>107</sup>US Panel Report, para. 8.257; Canada Panel Report, para. 8.260. The Panel pointed out that with respect to the five other hormones in dispute, JECFA, Codex and the European Communities itself have conducted or invoked risk assessments for each individual substance. Furthermore, the Panel referred to the paper presented at the 1995 EC Scientific Conference by J. Bridges and O. Bridges on "Hazards of Growth Promoting Agents and Strategies of Risk Assessment" (Conference Proceedings, p. 250). US Panel Report, para. 8.260; Canada Panel Report, para. 8.263.

<sup>108</sup>EC's appellant's submission, para. 350.

<sup>109</sup>EC's appellant's submission, para. 347.

<sup>110</sup>See, in particular, footnote 331 of the US Panel Report and footnote 437 of the Canada Panel Report.

distortion of relevant scientific evidence.<sup>117</sup> We note, however, that the Panel did consider the 1987 IARC Monographs but held that they could not be regarded as part of a risk assessment for the hormones at issue because the Monographs do not address the carcinogenic potential of these hormones when used specifically for growth promotion purposes or with respect to residue levels comparable to those present after such use<sup>118</sup>, or the potential for adverse effects arising from the presence in food of residues of the hormones in dispute or from residue levels comparable to those present in food. The Panel's distinction between general and specific studies and its treatment of the 1987 IARC Monographs does not, therefore, appear arbitrary. Furthermore, we note that the Panel concluded, in the alternative, that the Monographs have been taken into account in, and do not contradict, the other studies referred to by the European Communities, in particular the 1988 and 1989 JECFA Reports.<sup>119</sup> We believe that the Panel's treatment of the 1987 IARC Monographs does not amount to a distortion of evidence.

142. Fifth, the European Communities submits that the Panel made no attempt whatsoever to discuss "the scientific views and evidence presented by the other EC scientists" and therefore violated Article 11 of the DSU.<sup>120</sup> It is our understanding that the European Communities refers here to the articles and opinions of individual scientists that are included in the Panel's list of scientific evidence referred to by the European Communities.<sup>121</sup> We note that, contrary to what the European Communities claims, the Panel does discuss these articles and opinions of individual scientists. The Panel Report included a summary discussion of these articles and opinions.<sup>122</sup> However, as the Panel explains, the scientific evidence included in these articles and opinions relates to the carcinogenic or genotoxic potential of entire categories of hormones or the hormones at issue in general, not when used specifically for growth promotion purposes or with respect to residue levels comparable to those present in meat after such use. In our opinion, the Panel's treatment of the articles and opinions of individual scientists, like its treatment of the 1987 IARC Monographs, does not amount to a distortion of evidence.

### C. Evidence with Regard to the Issue of Control

<sup>117</sup>EC's appellant's submission, para. 368.

<sup>118</sup>US Panel Report, para. 8.127; Canada Panel Report, para. 8.130.

<sup>119</sup>US Panel Report, para. 8.129; Canada Panel Report, para. 8.132.

<sup>120</sup>EC's appellant's submission, para. 380.

<sup>121</sup>US Panel Report, para. 8.108; Canada Panel Report, para. 8.111.

<sup>122</sup>US Panel Report, para. 8.130; Canada Panel Report, para. 8.133. The Panel itself refers to some of the articles and opinions in paras. 4.131-4.136 and 4.180 of the US Panel Report, and paras. 4.154-4.166 of the Canada Panel Report.

143. With regard to the issue of control, the European Communities contends that the Panel failed to take into account the evidence submitted by the European Communities<sup>123</sup> and ignored statements made by some of its own experts.<sup>124</sup> We observe that the Panel did indeed not explicitly refer to all the evidence regarding the issue of control before it. The Panel had found that the risks related to the general problems of control should not be taken into account in risk assessment<sup>125</sup> and accordingly did not refer extensively to the evidence regarding the issue of control. Furthermore, we note that the Panel, subsequently and in the alternative, concluded that even if the issue of control, and the evidence relating to that issue, could be taken into account, the European Communities had not supplied convincing evidence. The Panel, it appears, excluded that evidence on the legal ground of non-relevancy; as will be seen later, the Panel erred in law in holding the evidence non-relevant. Nevertheless, it did examine the evidence.<sup>126</sup>

144. The European Communities also claims that the Panel incorrectly quoted the statements of its experts.<sup>127</sup> Referring to a number of specific statements<sup>128</sup>, the Panel stated that the experts advising the Panel made clear that the potential for abuse under a regime where the hormones in dispute are allowed under specified conditions and under the current regime where they are banned, would be comparable. The European Communities submits that in the statements referred to by the Panel, the experts either explicitly stated they were speculating or added strong reservations to their opinions. After reading these statements carefully, we come to the conclusion that the Panel did not in fact represent the opinions of its experts accurately. However, this mistake does not amount to the egregious disregarding or distorting of evidence before the Panel.

### D. Evidence on Article 5.5

<sup>123</sup>The European Communities contends that it submitted convincing specific evidence to the Panel that control would be more difficult under a regime where the hormones in dispute were allowed (under specific conditions of use) than under the current EC regime where the hormones in dispute are banned. It also contends that it submitted clear evidence to the Panel, specifying the risks for human health that the inadequate control of these hormones can pose and that in the United States and Canada there were instances in which the MRL's were not respected. Finally the European Communities submitted evidence relating the practical and technical difficulties that are specific to control of hormones. EC's appellant's submission, paras. 403-433.

<sup>124</sup>EC's appellant's submission, para. 416. The European Communities submits that, for example, Dr. André's reference to misuse in France (see para. 168 of the Annex to the US and Canada Panel Reports) and Dr. McLean's statement on the difficulty of controlling treatment of animals (see para. 474 of the Annex to the US and Canada Panel Reports) were not taken into account by the Panel.

<sup>125</sup>US Panel Report, para. 8.146; Canada Panel Report, para. 8.149.

<sup>126</sup>US Panel Report, para. 8.146; Canada Panel Report, para. 8.149.

<sup>127</sup>EC's appellant's submission, para. 419.

<sup>128</sup>US Panel Report, footnote 362; Canada Panel Report, footnote 469.

145. The European Communities claims that in finding that the difference in its levels of protection in respect of five of the hormones at issue and in respect of carbadox and olaquinox is arbitrary or unjustifiable<sup>129</sup>, the Panel did not take into account the evidence before it.<sup>130</sup> We note that the Panel considered in detail each of the arguments and related evidence referred to by the European Communities on this particular point.<sup>131</sup> Although the Panel did not agree with the arguments advanced by the European Communities, we do not believe that in doing so, the Panel arbitrarily ignored or manifestly distorted the evidence before it. We deal with these arguments below in some detail.<sup>132</sup>

IX. Certain Procedures Adopted by the Panel

A. The Selection and Use of Experts

146. The European Communities considers that in its selection and use of experts, the Panel has violated Article 11.2 of the SPS Agreement and Articles 11, 13.2 and Appendix 4 of the DSU.<sup>133</sup> We note that the Panel decided to request the opinion of experts on certain scientific and other technical matters raised by the parties to the dispute, and rather than establishing an experts review group, the Panel considered it more useful to leave open the possibility of receiving a range of opinions from the experts in their individual capacity. The Panel stresses, among other things, that:

We considered, however, that neither Article 11.2 of the SPS Agreement nor Article 13.2 of the DSU limits our right to seek information from individual experts as provided for in Article 11.2, first sentence, of the SPS Agreement and Articles 13.1 and 13.2, first sentence, of the DSU.<sup>134</sup>

<sup>129</sup>US Panel Report, para. 8.238; Canada Panel Report, para. 8.241.

<sup>130</sup>The European Communities argues that it had advanced six reasons why this distinction is not arbitrary or unjustifiable but the Panel rejected all these reasons, and in doing so, it failed to take into account the evidence before it. The reasons advanced by the European Communities were the following: first, that carbadox and olaquinox are not hormones and have a different mode of action; second, that carbadox and olaquinox act as growth promoters by combating the development of bacteria; third, that carbadox and olaquinox are only available in prepared feedstuffs in predetermined dosages; fourth, that there are no alternatives to carbadox and olaquinox; fifth, that carbadox cannot be abused; and sixth, that carbadox is used in very small quantities and is hardly absorbed. EC's appellant's submission, paras. 529-548.

<sup>131</sup>US Panel Report, paras. 8.231-8.238; Canada Panel Report, paras. 8.234-8.240.

<sup>132</sup>See paras. 227-235 of this Report.

<sup>133</sup>EC's appellant's submission, para. 587.

<sup>134</sup>US Panel Report, para. 8.7; Canada Panel Report, para. 8.7.

147. We agree with the Panel. Both Article 11.2 of the SPS Agreement and Article 13 of the DSU enable panels to seek information and advice as they deem appropriate in a particular case. Article 11.2 of the SPS Agreement states:

In a dispute under this Agreement involving scientific or technical issues, a panel should seek advice from experts chosen by the panel in consultation with the parties to the dispute. To this end, the panel may, when it deems it appropriate, establish an advisory technical experts group. (underlining added)

Article 13 of the DSU provides, in relevant part:

1. Each panel shall have the right to seek information and technical advice from any individual or body which it deems appropriate ...
2. Panels may seek information from any relevant source and may consult experts to obtain their opinion on certain aspects of the matter. With respect to a factual issue concerning a scientific or other technical matter raised by a party to the dispute, a panel may request an advisory report in writing from an experts review group ... (underlining added)

We find that in disputes involving scientific or technical issues, neither Article 11.2 of the SPS Agreement, nor Article 13 of the DSU prevents panels from consulting with individual experts. Rather, both the SPS Agreement and the DSU leave to the sound discretion of a panel the determination of whether the establishment of an expert review group is necessary or appropriate.

148. Both Article 11.2 of the SPS Agreement and Article 13.2 of the DSU require panels to consult with the parties to the dispute during the selection of the experts. However, it is not claimed by any of the participants in this appeal that the Panel did not consult with them when appointing the experts. Moreover, it is uncontested that the experts have been selected in accordance with procedures on which all the participants have previously agreed.<sup>135</sup> It is similarly uncontested that, among the experts consulted by the Panel, there are nationals from each of the parties to the dispute. The rules and procedures set forth in Appendix 4 of the DSU apply in situations in which expert review groups have been established. However, this is not the situation in this particular case. Consequently, once the panel has decided to request the opinion of individual scientific experts, there is no legal obstacle to the panel drawing up, in consultation with the parties to the dispute, ad hoc rules for those particular proceedings.

<sup>135</sup>US Panel Report, paras. 6.1-6.10; Canada Panel Report, paras. 6.1-6.9.

149. We conclude, therefore, that in its selection and use of experts, the Panel has not acted inconsistently with Articles 11, 13.2 and Appendix 4 of the DSU and Article 11.2 of the SPS Agreement.

B. Additional Third Party Rights to the United States and Canada

150. The European Communities contends that, notwithstanding its protest that these decisions affected its rights of defence, the Panel took a number of decisions granting additional third party rights to Canada and the United States which are not justified by Article 9.3 of the DSU, are inconsistent with Articles 7.1, 7.2, 18.2 and 10.3 thereof, and were not granted to the other third parties.<sup>136</sup> We recall that the European Communities refers to the following decisions of the Panel: first, to hold a joint meeting with scientific experts; second, to give access to all of the information submitted in the United States' proceeding to Canada; third, to give access to all of the information submitted in the Canadian proceeding to the United States; and fourth, to invite the United States to observe and make a statement at the second substantive meeting in the proceeding initiated by Canada.

151. Article 9.3 of the DSU reads as follows:

If more than one panel is established to examine the complaints related to the same matter, to the greatest extent possible the same persons shall serve as panelists on each of the separate panels and the timetable for the panel process in such disputes shall be harmonized.

After examining the procedural course of the two disputes, we consider that four aspects should be underlined. First, both proceedings dealt with the same matter. Second, all the parties to both disputes agreed that the same panelists would serve on both proceedings. Third, although the proceeding initiated by Canada started several months after the proceeding started by the United States, the Panel managed to finish the Panel Reports at the same time. Fourth, given the fact that the same panelists were conducting two proceedings dealing with the same matter, neither Canada nor the United States were ordinary third parties in each other's complaint.

152. With respect to the decision of the Panel to hold a joint meeting with scientific experts, the Panel explains as follows:

Prior to our meeting with scientific experts, we decided to hold that meeting jointly for both this Panel, requested by Canada, and the parallel panel requested by the United States. This decision stemmed from the similarities of the two cases (the same EC measures are at issue and both cases are dealt with by the same panel members), our decision to use the same scientific experts in both cases and the fact that we had already decided to invite Canada and the United States to participate in the meeting with scientific experts in each of the two cases. In addition, we considered that, from a practical perspective, there was a need to avoid repetition of arguments and/or questions at our meetings with the scientific experts. The European Communities objected to this decision arguing that one joint meeting with experts, instead of two separate meetings, was likely to affect its procedural rights of defence. Where it made precise claims of prejudice to its rights of defence, we took corrective action.<sup>137</sup>

We consider the explanation of the Panel quite reasonable, and its decision to hold a joint meeting with the scientific experts consistent with the letter and spirit of Article 9.3 of the DSU. Clearly, it would be an uneconomical use of time and resources to force the Panel to hold two successive but separate meetings gathering the same group of experts twice, expressing their views twice regarding the same scientific and technical matters related to the same contested EC measures. We do not believe that the Panel has erred by addressing the EC procedural objections only where the European Communities could make a precise claim of prejudice. It is evident to us that a procedural objection raised by a party to a dispute should be sufficiently specific to enable the panel to address it.<sup>138</sup>

153. The decision of the Panel to use and provide all information to the parties in both disputes was taken in view of its previous decision to hold a joint meeting with the experts.<sup>139</sup> The European Communities asserts that it cannot see how providing information in one of the proceedings to a party in the other helps to harmonize timetables.<sup>140</sup> We can see a relation between timetable harmonization within the meaning of Article 9.3 of the DSU and economy of effort. In disputes where the evaluation of scientific data and opinions plays a significant role, the panel that is established later can benefit from the information gathered in the context of the proceedings of the panel established earlier. Having access to a common pool of information enables the panel and the parties to save time by avoiding duplication

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<sup>137</sup>Canada Panel Report, para. 8.18. See also US Panel Report, para. 8.14.

<sup>138</sup>Furthermore, the DSU, and in particular its Appendix 3, leave panels a margin of discretion to deal, always in accordance with due process, with specific situations that may arise in a particular case and that are not explicitly regulated. Within this context, an appellant requesting the Appellate Body to reverse a panel's ruling on matters of procedure must demonstrate the prejudice generated by such legal ruling.

<sup>139</sup>US Panel Report, para. 8.15; Canada Panel Report, para. 8.19.

<sup>140</sup>EC's appellant's submission, para. 610.

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<sup>141</sup>EC's appellant's submission, paras. 605 and 612.

of the compilation and analysis of information already presented in the other proceeding.<sup>141</sup> Article 3.3 of the DSU recognizes the importance of avoiding unnecessary delays in the dispute settlement process and states that the prompt settlement of a dispute is essential to the effective functioning of the WTO. In this particular case, the Panel tried to avoid unnecessary delays, making an effort to comply with the letter and spirit of Article 9.3 of the DSU. Indeed, as noted earlier, despite the fact that the Canadian proceeding was initiated several months later than that of the United States, the Panel managed to finish both Panel Reports at the same time.

154. Regarding the participation of the United States in the second substantive meeting of the Panel requested by Canada, the Panel states:

This decision was, *inter alia*, based on the fact that our second meeting was held the day after our joint meeting with the scientific experts and that the parties to this dispute would, therefore, most likely comment on, and draw conclusions from, the evidence submitted by these experts to be considered in both cases. Since in the panel requested by the United States the second meeting was held before the joint meeting with scientific experts, we considered it appropriate, in order to safeguard the rights of the United States in the proceeding it requested, to grant the United States the opportunity to observe our second meeting in this case and to make a brief statement at the end of that meeting.<sup>142</sup>

The explanation of the Panel appears reasonable to us. If the Panel had not given the United States an opportunity to participate in the second substantive meeting of the proceedings initiated by Canada, the United States would not have had the same degree of opportunity to comment on the views expressed by the scientific experts that the European Communities and Canada enjoyed. Although Article 12.1 and Appendix 3 of the DSU do not specifically require the Panel to grant this opportunity to the United States, we believe that this decision falls within the sound discretion and authority of the Panel, particularly if the Panel considers it necessary for ensuring to all parties due process of law. In this regard, we note that in *European Communities - Bananas*<sup>143</sup>, the panel considered that particular circumstances justified the grant to third parties of rights somewhat broader than those explicitly envisaged in Article 10 and Appendix 3 of the DSU. We conclude that, in the case before us, circumstances justified the Panel's

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<sup>141</sup>Moreover, in the proceeding initiated by Canada, the European Communities made references to materials that it had previously submitted in the proceeding initiated by the United States. Canada's appellee's submission, para. 216.

<sup>142</sup>Canada Panel Report, para. 8.20.

<sup>143</sup>Adopted 25 September 1997, WT/DS27/AB/R.

decision to allow the United States to participate in the second substantive meeting of the proceedings initiated by Canada.

C. The Difference Between Legal Claims and Arguments

155. Arguing that panels are not entitled to make findings beyond what has been requested by the parties, the European Communities asserts that the Panel has erred by basing the main part of its reasoning on Article 5.5 of the SPS Agreement on a claim that the complainants had not made.<sup>144</sup> According to the European Communities, the complainants did not complain of a supposed difference of treatment between artificially added or exogenous natural and synthetic hormones when used for growth promotion purposes compared with the naturally present endogenous hormones in untreated meat and other foods (such as milk, cabbage, broccoli or eggs). The European Communities states that nowhere in the sections of the Panel Reports summarising the arguments on Article 5.5 is there any mention of such an argument.

156. Considering that in the request for the establishment of a panel in the proceeding initiated by the United States<sup>145</sup>, as well as in the proceeding started by Canada<sup>146</sup>, both complainants have included a claim that the EC ban is inconsistent with Article 5 of the SPS Agreement, we believe that the objection of the European Communities overlooks the distinction between legal claims made by the complainant and arguments used by that complainant to sustain its legal claims. In *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products* we said:

We stated ... in *Brazil - Desiccated Coconut* that all claims must be included in the request for establishment of a panel in order to come within the panel's terms of reference, based on the practice of panels under the GATT 1947 and the Tokyo Round Codes. That past practice required that a claim had to be included in the documents referred to, or contained in, in the terms of reference in order to form part of the "matter" referred to a panel for consideration. Following both this past practice and the provisions of the DSU, in *European Communities - Bananas*, we observed that there is a significant difference between the claims identified in the request for the establishment of a panel, which establish the panel's terms of reference under Article 7 of the DSU, and the arguments supporting those claims, which are set out and progressively clarified in the first written submissions, the rebuttal

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<sup>144</sup>EC's appellant's submission, paras. 495 and 594.

<sup>145</sup>WT/DS26/6, 25 April 1996.

<sup>146</sup>WT/DS48/5, 17 September 1996.

submissions and the first and second panel meetings with the parties as a case proceeds.<sup>147</sup> (footnotes omitted)

Panels are inhibited from addressing legal claims falling outside their terms of reference. However, nothing in the DSU limits the faculty of a panel freely to use arguments submitted by any of the parties -- or to develop its own legal reasoning -- to support its own findings and conclusions on the matter under its consideration. A panel might well be unable to carry out an objective assessment of the matter, as mandated by Article 11 of the DSU, if in its reasoning it had to restrict itself solely to arguments presented by the parties to the dispute. Given that in this particular case both complainants claimed that the EC measures were inconsistent with Article 5.5 of the SPS Agreement, we conclude that the Panel did not make any legal finding beyond those requested by the parties.

X. The Interpretation of Articles 3.1 and 3.3 of the SPS Agreement

157. The European Communities appeals from the conclusion of the Panel that the European Communities, by maintaining SPS measures which are not based on existing international standards without justification under Article 3.3 of the SPS Agreement, has acted inconsistently with the requirements contained in Article 3.1 of that Agreement.

158. It will be seen below that the Panel is actually saying that the European Communities acted inconsistently with the requirements of both Articles 3.1 and 3.3 of the SPS Agreement, a position that flows from the Panel's view of a supposed "general rule - exception" relationship between Articles 3.1 and 3.3, a view we have indicated we do not share.<sup>148</sup>

159. The above conclusion of the Panel has three components: first, international standards, guidelines and recommendations exist in respect of meat and meat products derived from cattle to which five of the hormones involved have been administered for growth promotion purposes; secondly, the EC measures involved here are not based on the relevant international standards, guidelines and recommendations developed by Codex, because such measures are not in conformity with those standards, guidelines and recommendations; and thirdly, the EC measures are "not justified under", that is, do not comply with the requirements of Article 3.3. En route to its above-mentioned conclusion, the Panel developed three

legal interpretations, which have all been appealed by the European Communities and which need to be addressed: the first relates to the meaning of "based on" as used in Article 3.1; the second is concerned with the relationship between Articles 3.1, 3.2 and 3.3 of the SPS Agreement; and the third relates to the requirements of Article 3.3 of the SPS Agreement. As may be expected, the Panel's three interpretations are intertwined.

A. The Meaning of "Based On" as Used in Article 3.1 of the SPS Agreement

160. Article 3.1 provides:

To harmonize sanitary and phytosanitary measures on as wide a basis as possible, Members shall base their sanitary or phytosanitary measures on international standards, guidelines or recommendations, where they exist, except as otherwise provided for in this Agreement, and in particular in paragraph 3.

161. Addressing the meaning of "based on", the Panel constructs the following interpretations:

The SPS Agreement does not explicitly define the words based on as used in Article 3.1. However, Article 3.2, which introduces a presumption of consistency with both the SPS Agreement and GATT for sanitary measures which conform to international standards, equates measures based on international standards with measures which conform to such standards. Article 3.3, in turn, explicitly relates the definition of sanitary measures based on international standards to the level of sanitary protection achieved by these measures. Article 3.3 stipulates the conditions to be met for a Member to enact or maintain certain sanitary measures which are not based on international standards. It applies more specifically to measures "which result in a higher level of sanitary ... protection than would be achieved by measures based on the relevant international standards" or measures "which result in a level of sanitary ... protection different from that which would be achieved by measures based on international standards". One of the determining factors in deciding whether a measure is based on an international standard is, therefore, the level of protection that measure achieves. According to Article 3.3 all measures which are based on a given international standard should in principle achieve the same level of sanitary protection. Therefore, if an international standard reflects a specific level of sanitary protection and a sanitary measure implies a different level, that measure cannot be considered to be based on the international standard.

We find, therefore, that for a sanitary measure to be based on an international standard in accordance with Article 3.1, that measure needs

<sup>147</sup> Adopted 16 January 1998, WT/DS50/AB/R, para. 88.

<sup>148</sup> See paras. 104 and 106 of this Report.

to reflect the same level of sanitary protection as the standard. In this dispute a comparison thus needs to be made between the level of protection reflected in the EC measures in dispute and that reflected in the Codex standards for each of the five hormones at issue.<sup>149</sup> (underlining added)

162. We read the Panel's interpretation that Article 3.2 "equates" measures "based on" international standards with measures which "conform to" such standards, as signifying that "based on" and "conform to" are identical in meaning. The Panel is thus saying that, henceforth, SPS measures of Members must "conform to" Codex standards, guidelines and recommendations.

163. We are unable to accept this interpretation of the Panel. In the first place, the ordinary meaning of "based on" is quite different from the plain or natural import of "conform to". A thing is commonly said to be "based on" another thing when the former "stands" or is "founded" or "built" upon or "is supported by" the latter.<sup>150</sup> In contrast, much more is required before one thing may be regarded as "conform[ing] to" another: the former must "comply with", "yield or show compliance" with the latter. The reference of "conform to" is to "correspondence in form or manner", to "compliance with" or "acquiescence", to "follow[ing] in form or nature".<sup>151</sup> A measure that "conforms to" and incorporates a Codex standard is, of course, "based on" that standard. A measure, however, based on the same standard might not conform to that standard, as where only some, not all, of the elements of the standard are incorporated into the measure.

164. In the second place, "based on" and "conform to" are used in different articles, as well as in differing paragraphs of the same article. Thus, Article 2.2 uses "based on", while Article 2.4 employs "conform to". Article 3.1 requires the Members to "base" their SPS measures on international standards; however, Article 3.2 speaks of measures which "conform to" international standards. Article 3.3 once again refers to measures "based on" international standards. The implication arises that the choice and use of different words in different places in the SPS Agreement are deliberate, and that the different words are designed to convey different meanings. A treaty interpreter is not entitled to assume that such usage was merely inadvertent on the part of the Members who negotiated and wrote that Agreement.<sup>152</sup> Canada has suggested

<sup>149</sup>US Panel Report, paras. 8.72 and 8.73; Canada Panel Report, paras. 8.75 and 8.76.

<sup>150</sup>L. Brown (ed.), *The New Shorter Oxford English Dictionary on Historical Principles* (Clarendon Press), Vol. I, p. 187.

<sup>151</sup>L. Brown (ed.), *The New Shorter Oxford English Dictionary on Historical Principles* (Clarendon Press), Vol. I, p. 477.

<sup>152</sup>Appellate Body Report, *United States - Underwear*, adopted 25 February 1997, WT/DS24/AB/R, p. 17.

the use of different terms was "accidental" in this case, but has offered no convincing argument to support its suggestion. We do not believe this suggestion has overturned the inference of deliberate choice.

165. In the third place, the object and purpose of Article 3 run counter to the Panel's interpretation. That purpose, Article 3.1 states, is "[t]o harmonize [SPS] measures on as wide a basis as possible ....". The preamble of the SPS Agreement also records that the Members "[d]esir[e] to further the use of harmonized [SPS] measures between Members on the basis of international standards, guidelines and recommendations developed by the relevant international organizations ...." (emphasis added) Article 12.1 created a Committee on Sanitary and Phytosanitary Measures and gave it the task, *inter alia*, of "furtherance of its objectives, in particular with respect to harmonization" and (in Article 12.2) to "encourage the use of international standards, guidelines and recommendations by all Members". It is clear to us that harmonization of SPS measures of Members on the basis of international standards is projected in the Agreement, as a goal, yet to be realized in the future. To read Article 3.1 as requiring Members to harmonize their SPS measures by conforming those measures with international standards, guidelines and recommendations, in the here and now, is, in effect, to vest such international standards, guidelines and recommendations (which are by the terms of the Codex recommendatory in form and nature<sup>153</sup>) with obligatory force and effect. The Panel's interpretation of Article 3.1 would, in other words, transform those standards, guidelines and recommendations into binding norms. But, as already noted, the SPS Agreement itself sets out no indication of any intent on the part of the Members to do so. We cannot lightly assume that sovereign states intended to impose upon themselves the more onerous, rather than the less burdensome, obligation by mandating conformity or compliance with such standards, guidelines and recommendations.<sup>154</sup> To sustain such an assumption and to warrant such a far-reaching interpretation,

<sup>153</sup>US Panel Report, para. 8.59; Canada Panel Report, para. 8.62.

<sup>154</sup>The interpretative principle of *in dubio mitius*, widely recognized in international law as a "supplementary means of interpretation", has been expressed in the following terms:

"The principle of *in dubio mitius* applies in interpreting treaties, in deference to the sovereignty of states. If the meaning of a term is ambiguous, that meaning is to be preferred which is less onerous to the party assuming an obligation, or which interferes less with the territorial and personal supremacy of a party, or involves less general restrictions upon the parties."

R. Jennings and A. Watts (eds.), *Oppenheim's International Law*, 9th ed., Vol. I (Longman, 1992), p. 1278. The relevant case law includes: *Nuclear Tests Case (Australia v. France)*, (1974), I.C.J. Reports, p. 267 (International Court of Justice); *Access of Polish War Vessels to the Port of Danzig* (1931) PCIJ Rep., Series A/B, No. 43, p. 142 (Permanent Court of International Justice); *USA-France Air Transport Services Arbitration* (1963), 38 *International Law Reports* 243 (Arbitral Tribunal); *De Passale Claim* (1961), 40 *International Law Reports* 250 (Italian - United States Conciliation Commission). See also: I. Brownlie, *Principles of Public International Law*, 4th ed. (Clarendon Press, 1990), p. 631; C. Rousseau, *Droit International Public*, Vol. I (1990), p. 273; D. Carreau, *Droit International*, 4th ed. (Editions A. Pedone, 1994), p. 142; M. Díez de Velasco, *Instituciones de Derecho Internacional Público*, 9th ed., Vol. I (Editorial Tecnos, 1991), pp. 163-164; and B. Conforti, *Diritto Internazionale*, 3rd ed. (Editoriale Scientifica, 1987), pp. 99-100.

treaty language far more specific and compelling than that found in Article 3 of the SPS Agreement would be necessary.

166. Accordingly, we disagree with the Panel's interpretation that "based on" means the same thing as "conform to".

167. After having erroneously "equated" measures "based on" an international standard with measures that "conform to" that standard<sup>155</sup>, the Panel proceeds to Article 3.3. According to the Panel, Article 3.3 "explicitly relates" the "definition of sanitary measures based on international standards to the level of sanitary protection achieved by those measures". The Panel then interprets Article 3.3 as saying that "all measures which are based on a given international standard should in principle achieve the same level of sanitary protection", and argues a contrario that "if a sanitary measure implies a different level (from that reflected in an international standard), that measure cannot be considered to be based on the international standard". The Panel concludes that, under Article 3.1, "for a sanitary measure to be based on an international standard ..., that measure needs to reflect the same level of sanitary protection as the standard".<sup>156</sup>

168. It appears to us that the Panel reads much more into Article 3.3 than can be reasonably supported by the actual text of Article 3.3. Moreover, the Panel's entire analysis rests on its flawed premise that "based on", as used in Articles 3.1 and 3.3, means the same thing as "conform to" as used in Article 3.2. As already noted, we are compelled to reject this premise as an error in law. The correctness of the rest of the Panel's intricate interpretation and examination of the consequences of the Panel's litmus test, however, have to be left for another day and another case.

#### B. Relationship Between Articles 3.1, 3.2 and 3.3 of the SPS Agreement

169. We turn to the relationship between Articles 3.1, 3.2 and 3.3 of the SPS Agreement. As observed earlier, the Panel assimilated Articles 3.1 and 3.2 to one another, designating the product as the "general rule", and contraposed that product to Article 3.3 which denoted the "exception". This view appears to us an erroneous representation of the differing situations that may arise under Article 3, that is, where a relevant international standard, guideline or recommendation exists.

170. Under Article 3.2 of the SPS Agreement, a Member may decide to promulgate an SPS measure that conforms to an international standard. Such a measure would embody the international standard completely and, for practical purposes, convert it into a municipal standard. Such a measure enjoys the benefit of a presumption (albeit a rebuttable one) that it is consistent with the relevant provisions of the SPS Agreement and of the GATT 1994.

171. Under Article 3.1 of the SPS Agreement, a Member may choose to establish an SPS measure that is based on the existing relevant international standard, guideline or recommendation. Such a measure may adopt some, not necessarily all, of the elements of the international standard. The Member imposing this measure does not benefit from the presumption of consistency set up in Article 3.2; but, as earlier observed, the Member is not penalized by exemption of a complaining Member from the normal burden of showing a prima facie case of inconsistency with Article 3.1 or any other relevant article of the SPS Agreement or of the GATT 1994.

172. Under Article 3.3 of the SPS Agreement, a Member may decide to set for itself a level of protection different from that implicit in the international standard, and to implement or embody that level of protection in a measure not "based on" the international standard. The Member's appropriate level of protection may be higher than that implied in the international standard. The right of a Member to determine its own appropriate level of sanitary protection is an important right. This is made clear in the sixth preambular paragraph of the SPS Agreement:

Members,

...

Desiring to further the use of harmonized sanitary and phytosanitary measures between Members, on the basis of international standards, guidelines and recommendations developed by the relevant international organizations, including the Codex Alimentarius Commission, the International Office of Epizootics, and the relevant international and regional organizations operating within the framework of the International Plant Protection Convention, without requiring Members to change their appropriate level of protection of human, animal or plant life or health; (underlining added)

As noted earlier, this right of a Member to establish its own level of sanitary protection under Article 3.3 of the SPS Agreement is an autonomous right and not an "exception" from a "general obligation" under Article 3.1.

<sup>155</sup>US Panel Report, para. 8.72; Canada Panel Report, para. 8.75.

<sup>156</sup>US Panel Report, para. 8.73; Canada Panel Report, para. 8.76.

C. The Requirements of Article 3.3 of the SPS Agreement

173. The right of a Member to define its appropriate level of protection is not, however, an absolute or unqualified right. Article 3.3 also makes this clear:

Members may introduce or maintain sanitary or phytosanitary measures which result in a higher level of sanitary or phytosanitary protection than would be achieved by measures based on the relevant international standards, guidelines or recommendations, if there is a scientific justification, or as a consequence of the level of sanitary or phytosanitary protection a Member determines to be appropriate in accordance with the relevant provisions of paragraphs 1 through 8 of Article 5.<sup>157</sup> Notwithstanding the above, all measures which result in a level of sanitary or phytosanitary protection different from that which would be achieved by measures based on international standards, guidelines or recommendations shall not be inconsistent with any other provision of this Agreement.

<sup>157</sup>For the purposes of paragraph 3 of Article 3, there is a scientific justification if, on the basis of an examination and evaluation of available scientific information in conformity with the relevant provisions of this Agreement, a Member determines that the relevant international standards, guidelines or recommendations are not sufficient to achieve its appropriate level of sanitary or phytosanitary protection.

174. The European Communities argues that there are two situations covered by Article 3.3 and that its SPS measures are within the first of these situations.<sup>157</sup> It is claimed that the European Communities has maintained SPS measures "which result in a higher level of ... protection than would be achieved by measures based on the relevant" Codex standard, guideline or recommendation, for which measures "there is a scientific justification".<sup>158</sup> It is also, accordingly, argued that the requirement of a risk assessment under Article 5.1 does not apply to the European Communities. At the same time, it is emphasized that the EC measures have satisfied the requirements of Article 2.2.<sup>159</sup>

175. Article 3.3 is evidently not a model of clarity in drafting and communication. The use of the disjunctive "or" does indicate that two situations are intended to be covered. These are the introduction or maintenance of SPS measures which result in a higher level of protection:

- (a) "if there is a scientific justification"; or

- (b) "as a consequence of the level of ... protection a Member determines to be appropriate in accordance with the relevant provisions of paragraphs 1 through 8 of Article 5".

It is true that situation (a) does not speak of Articles 5.1 through 5.8. Nevertheless, two points need to be noted. First, the last sentence of Article 3.3 requires that "all measures which result in a [higher] level of ... protection", that is to say, measures falling within situation (a) as well as those falling within situation (b), be "not inconsistent with any other provision of [the SPS] Agreement". "Any other provision of this Agreement" textually includes Article 5. Secondly, the footnote to Article 3.3, while attached to the end of the first sentence, defines "scientific justification" as an "examination and evaluation of available scientific information in conformity with relevant provisions of this Agreement ...". This examination and evaluation would appear to partake of the nature of the risk assessment required in Article 5.1 and defined in paragraph 4 of Annex A of the SPS Agreement.

176. On balance, we agree with the Panel's finding that although the European Communities has established for itself a level of protection higher, or more exacting, than the level of protection implied in the relevant Codex standards, guidelines or recommendations, the European Communities was bound to comply with the requirements established in Article 5.1. We are not unaware that this finding tends to suggest that the distinction made in Article 3.3 between two situations may have very limited effects and may, to that extent, be more apparent than real. Its involved and layered language actually leaves us with no choice.

177. Consideration of the object and purpose of Article 3 and of the SPS Agreement as a whole reinforces our belief that compliance with Article 5.1 was intended as a countervailing factor in respect of the right of Members to set their appropriate level of protection. In generalized terms, the object and purpose of Article 3 is to promote the harmonization of the SPS measures of Members on as wide a basis as possible, while recognizing and safeguarding, at the same time, the right and duty of Members to protect the life and health of their people. The ultimate goal of the harmonization of SPS measures is to prevent the use of such measures for arbitrary or unjustifiable discrimination between Members or as a disguised restriction on international trade, without preventing Members from adopting or enforcing measures which are both "necessary to protect" human life or health and "based on scientific principles", and without requiring them to change their appropriate level of protection. The requirements of a risk assessment under Article 5.1, as well as of "sufficient scientific evidence" under Article 2.2, are essential for the maintenance of the delicate and carefully negotiated balance in the SPS Agreement between the shared, but sometimes competing, interests of promoting international trade and of protecting the life and health

<sup>157</sup>EC's appellant's submission, paras. 240-244.

<sup>158</sup>SPS Agreement, Article 3.3.

<sup>159</sup>EC's appellee's submission, para. 88.

of human beings. We conclude that the Panel's finding that the European Communities is required by Article 3.3 to comply with the requirements of Article 5.1 is correct and, accordingly, dismiss the appeal of the European Communities from that ruling of the Panel.

XI. The Reading of Articles 5.1 and 5.2 of the SPS Agreement: Basing SPS Measures on a Risk Assessment

178. We turn to the appeal of European Communities from the Panel's conclusion that, by maintaining SPS measures which are not based on a risk assessment, the European Communities acted inconsistently with the requirements contained in Article 5.1 of the SPS Agreement.

179. Article 5.1 of the SPS Agreement provides:

Members shall ensure that their sanitary or phytosanitary measures are based on an assessment, as appropriate to the circumstances, of the risks to human, animal or plant life or health, taking into account risk assessment techniques developed by the relevant international organizations. (underlining added)

A. The Interpretation of "Risk Assessment"

180. At the outset, two preliminary considerations need to be brought out. The first is that the Panel considered that Article 5.1 may be viewed as a specific application of the basic obligations contained in Article 2.2 of the SPS Agreement<sup>160</sup>, which reads as follows:

Members shall ensure that any sanitary or phytosanitary measure is applied only to the extent necessary to protect human, animal or plant life or health, is based on scientific principles and is not maintained without sufficient scientific evidence, except as provided for in paragraph 7 of Article 5. (underlining added)

We agree with this general consideration and would also stress that Articles 2.2 and 5.1 should constantly be read together. Article 2.2 informs Article 5.1: the elements that define the basic obligation set out in Article 2.2 impart meaning to Article 5.1.

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<sup>160</sup>US Panel Report, para. 8.93; Canada Panel Report, para. 8.96.

181. The second preliminary consideration relates to the Panel's effort to distinguish between "risk assessment" and "risk management". The Panel observed that an assessment of risk is, at least with respect to risks to human life and health, a "scientific" examination of data and factual studies; it is not, in the view of the Panel, a "policy" exercise involving social value judgments made by political bodies.<sup>161</sup> The Panel describes the latter as "non-scientific" and as pertaining to "risk management" rather than to "risk assessment".<sup>162</sup> We must stress, in this connection, that Article 5 and Annex A of the SPS Agreement speak of "risk assessment" only and that the term "risk management" is not to be found either in Article 5 or in any other provision of the SPS Agreement. Thus, the Panel's distinction, which it apparently employs to achieve or support what appears to be a restrictive notion of risk assessment, has no textual basis. The fundamental rule of treaty interpretation requires a treaty interpreter to read and interpret the words actually used by the agreement under examination, and not words which the interpreter may feel should have been used.

I. Risk Assessment and the Notion of "Risk"

182. Paragraph 4 of Annex A of the SPS Agreement sets out the treaty definition of risk assessment: This definition, to the extent pertinent to the present appeal, speaks of:

... the evaluation of the potential for adverse effects on human or animal health arising from the presence of additives, contaminants, toxins or disease-causing organisms in food, beverages or feedstuffs. (underlining added)

183. Interpreting the above definition, the Panel elaborates risk assessment as a two-step process that "should (i) identify the adverse effects on human health (if any) arising from the presence of the hormones at issue when used as growth promoters in meat ..., and (ii) if any such adverse effects exist, evaluate the potential or probability of occurrence of such effects".<sup>163</sup>

184. The European Communities appeals from the above interpretation as involving an erroneous notion of risk and risk assessment. Although the utility of a two-step analysis may be debated, it does not appear to us to be substantially wrong. What needs to be pointed out at this stage is that the Panel's use of "probability" as an alternative term for "potential" creates a significant concern. The ordinary

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<sup>161</sup>US Panel Report, para. 8.94; Canada Panel Report, para. 8.97.

<sup>162</sup>US Panel Report, para. 8.95; Canada Panel Report, para. 8.98.

<sup>163</sup>US Panel Report, para. 8.98; Canada Panel Report, para. 8.101.

meaning of "potential" relates to "possibility" and is different from the ordinary meaning of "probability".<sup>164</sup> "Probability" implies a higher degree or a threshold of potentiality or possibility. It thus appears that here the Panel introduces a quantitative dimension to the notion of risk.

185. In its discussion on a statement made by Dr. Lucier at the joint meeting with the experts in February 1997<sup>165</sup>, the Panel states the risk referred to by this expert is an estimate which "... only represents a statistical range of 0 to 1 in a million, not a scientifically identified risk".<sup>166</sup> The European Communities protests vigorously that, by doing so, the Panel is in effect requiring a Member carrying out a risk assessment to quantify the potential for adverse effects on human health.<sup>167</sup>

186. It is not clear in what sense the Panel uses the term "scientifically identified risk". The Panel also frequently uses the term "identifiable risk"<sup>168</sup>, and does not define this term either. The Panel might arguably have used the terms "scientifically identified risk" and "identifiable risk" simply to refer to an ascertainable risk: if a risk is not ascertainable, how does a Member ever know or demonstrate that it exists? In one part of its Reports, the Panel opposes a requirement of an "identifiable risk" to the uncertainty that theoretically always remains since science can never provide absolute certainty that a given substance will not ever have adverse health effects.<sup>169</sup> We agree with the Panel that this theoretical uncertainty is not the kind of risk which, under Article 5.1, is to be assessed. In another part of its Reports, however, the Panel appeared to be using the term "scientifically identified risk" to prescribe implicitly that a certain magnitude or threshold level of risk be demonstrated in a risk assessment if an SPS measure based thereon is to be regarded as consistent with Article 5.1.<sup>170</sup> To the extent that the Panel purported to require a risk assessment to establish a minimum magnitude of risk, we must note that imposition of such a quantitative requirement finds no basis in the SPS Agreement. A panel is authorized only to determine whether a given SPS measure is "based on" a risk assessment. As will be elaborated below, this means that a panel

<sup>164</sup>The dictionary meaning of "potential" is "that which is possible as opposed to actual; a possibility"; L. Brown (ed.), *The New Shorter Oxford English Dictionary on Historical Principles*, Vol. 2, p. 2310 (Clarendon Press, 1993). In contrast, "probability" refers to "degrees of likelihood; the appearance of truth, or likelihood of being realized", and "a thing judged likely to be true, to exist, or to happen"; *Id.*, p. 2362.

<sup>165</sup>Para. 819 of the Annex to the US and Canada Panel Reports.

<sup>166</sup>US Panel Report, footnote 331; Canada Panel Report, footnote 437.

<sup>167</sup>EC's appellant's submission, paras. 392-397.

<sup>168</sup>US Panel Report, paras. 8.124, 8.134, 8.136, 8.151, 8.153, 8.161, 8.162; Canada Panel Report, paras. 8.127, 8.137, 8.139, 8.154, 8.156, 8.164, 8.165.

<sup>169</sup>US Panel Report, paras. 8.152-8.153; Canada Panel Report, paras. 8.155-8.156

<sup>170</sup>US Panel Report, footnote 331; Canada Panel Report, footnote 437.

has to determine whether an SPS measure is sufficiently supported or reasonably warranted by the risk assessment.

2. Factors to be Considered in Carrying Out a Risk Assessment

187. Article 5.2 of the SPS Agreement provides an indication of the factors that should be taken into account in the assessment of risk. Article 5.2 states that:

In the assessment of risks, Members shall take into account available scientific evidence; relevant processes and production methods; relevant inspection, sampling and testing methods; prevalence of specific diseases or pests; existence of pest- or disease-free areas; relevant ecological and environmental conditions; and quarantine or other treatment.

The listing in Article 5.2 begins with "available scientific evidence"; this, however, is only the beginning. We note in this connection that the Panel states that, for purposes of the EC measures in dispute, a risk assessment required by Article 5.1 is "a scientific process aimed at establishing the scientific basis for the sanitary measure a Member intends to take".<sup>171</sup> To the extent that the Panel intended to refer to a process characterized by systematic, disciplined and objective enquiry and analysis, that is, a mode of studying and sorting out facts and opinions, the Panel's statement is unexceptionable.<sup>172</sup> However, to the extent that the Panel purports to exclude from the scope of a risk assessment in the sense of Article 5.1, all matters not susceptible of quantitative analysis by the empirical or experimental laboratory methods commonly associated with the physical sciences, we believe that the Panel is in error. Some of the kinds of factors listed in Article 5.2 such as "relevant processes and production methods" and "relevant inspection, sampling and testing methods" are not necessarily or wholly susceptible of investigation according to laboratory methods of, for example, biochemistry or pharmacology. Furthermore, there is nothing to indicate that the listing of factors that may be taken into account in a risk assessment of Article 5.2 was intended to be a closed list. It is essential to bear in mind that the risk that is to be evaluated in a risk assessment under Article 5.1 is not only risk ascertainable in a science laboratory operating under strictly

<sup>171</sup>US Panel Report, para. 8.107; Canada Panel Report, para. 8.110.

<sup>172</sup>The ordinary meaning of 'scientific', as provided by dictionary definitions, includes 'of, relating to, or used in science', broadly, 'having or appearing to have an exact, objective, factual, systematic or methodological basis', 'of, relating to, or exhibiting the methods or principles of science' and 'of, pertaining to, using, or based on the methodology of science'. Dictionary definitions of 'science' include 'the observation, identification, description, experimental investigation, and theoretical explanation of natural phenomena', 'any methodological activity, discipline, or study', and 'knowledge attained through study or practice'. (footnotes omitted) United States' Statement of Administrative Action, Uruguay Round Agreements Act, 203d Congress, 2d Session, House Document 103-316, Vol. 1, 27 September 1994, p. 90.

controlled conditions, but also risk in human societies as they actually exist, in other words, the actual potential for adverse effects on human health in the real world where people live and work and die.

B. The Interpretation of "Based On"

1. A "Minimum Procedural Requirement" in Article 5.1?

188. Although it expressly recognizes that Article 5.1 does not contain any specific procedural requirements for a Member to base its sanitary measures on a risk assessment, the Panel nevertheless proceeds to declare that "there is a minimum procedural requirement contained in Article 5.1". That requirement is that "the Member imposing a sanitary measure needs to submit evidence that at least it actually took into account a risk assessment when it enacted or maintained its sanitary measure in order for that measure to be considered as based on a risk assessment".<sup>173</sup> The Panel goes on to state that the European Communities did not provide any evidence that the studies it referred to or the scientific conclusions reached therein "have actually been taken into account by the competent EC institutions either when it enacted those measures (in 1981 and 1988) or at any later point in time".<sup>174</sup> (emphasis added) Thereupon, the Panel holds that such studies could not be considered as part of a risk assessment on which the European Communities based its measures in dispute. Concluding that the European Communities had not met its burden of proving that it had satisfied the "minimum procedural requirement" it had found in Article 5.1, the Panel holds the EC measures as inconsistent with the requirements of Article 5.1.

189. We are bound to note that, as the Panel itself acknowledges, no textual basis exists in Article 5 of the SPS Agreement for such a "minimum procedural requirement". The term "based on", when applied as a "minimum procedural requirement" by the Panel, may be seen to refer to a human action, such as particular human individuals "taking into account" a document described as a risk assessment. Thus, "take into account" is apparently used by the Panel to refer to some subjectivity which, at some time, may be present in particular individuals but that, in the end, may be totally rejected by those individuals. We believe that "based on" is appropriately taken to refer to a certain objective relationship between two elements, that is to say, to an objective situation that persists and is observable between an SPS measure and a risk assessment. Such a reference is certainly embraced in the ordinary meaning of the words "based on" and, when considered in context and in the light of the object and purpose of Article 5.1 of the SPS

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<sup>173</sup>US Panel Report, para. 8.113; Canada Panel Report, para. 8.116.

<sup>174</sup>US Panel Report, para. 8.114; Canada Panel Report, para. 8.117.

Agreement, may be seen to be more appropriate than "taking into account". We do not share the Panel's interpretative construction and believe it is unnecessary and an error of law as well.

190. Article 5.1 does not insist that a Member that adopts a sanitary measure shall have carried out its own risk assessment. It only requires that the SPS measures be "based on an assessment, as appropriate for the circumstances ...". The SPS measure might well find its objective justification in a risk assessment carried out by another Member, or an international organization. The "minimum procedural requirement" constructed by the Panel, could well lead to the elimination or disregard of available scientific evidence that rationally supports the SPS measure being examined. This risk of exclusion of available scientific evidence may be particularly significant for the bulk of SPS measures which were put in place before the effective date of the WTO Agreement and that have been simply maintained thereafter.

191. In the course of demanding evidence that EC authorities actually "took into account" certain scientific studies, the Panel refers to the preambles of the EC Directives here involved. The Panel notes that such preambles did not mention any of the scientific studies referred to by the European Communities in the panel proceedings. Preambles of legislative or quasi-legislative acts and administrative regulations commonly fulfil requirements of the internal legal orders of WTO Members. Such preambles are certainly not required by the SPS Agreement; they are not normally used to demonstrate that a Member has complied with its obligations under international agreements. The absence of any mention of scientific studies in the preliminary sections of the EC Directives does not, therefore, prove anything so far as the present case is concerned.

2. Substantive Requirement of Article 5.1 - Rational Relationship Between an SPS Measure and a Risk Assessment

192. Having posited a "minimum procedural requirement" of Article 5.1, the Panel turns to the "substantive requirements" of Article 5.1 to determine whether the EC measures at issue are "based on" a risk assessment. In the Panel's view, those "substantive requirements" involve two kinds of operations: first, identifying the scientific conclusions reached in the risk assessment and the scientific conclusions implicit in the SPS measures; and secondly, examining those scientific conclusions to determine whether or not one set of conclusions matches, i.e. conforms with, the second set of conclusions.<sup>175</sup> Applying the "substantive requirements" it finds in Article 5.1, the Panel holds that the scientific conclusions implicit

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<sup>175</sup>US Panel Report, para. 8.117; Canada Panel Report, para. 8.120.

in the EC measures do not conform with any of the scientific conclusions reached in the scientific studies the European Communities had submitted as evidence.<sup>176</sup>

193. We consider that, in principle, the Panel's approach of examining the scientific conclusions implicit in the SPS measure under consideration and the scientific conclusion yielded by a risk assessment is a useful approach. The relationship between those two sets of conclusions is certainly relevant; they cannot, however, be assigned relevance to the exclusion of everything else. We believe that Article 5.1, when contextually read as it should be, in conjunction with and as informed by Article 2.2 of the SPS Agreement, requires that the results of the risk assessment must sufficiently warrant -- that is to say, reasonably support -- the SPS measure at stake. The requirement that an SPS measure be "based on" a risk assessment is a substantive requirement that there be a rational relationship between the measure and the risk assessment.

194. We do not believe that a risk assessment has to come to a monolithic conclusion that coincides with the scientific conclusion or view implicit in the SPS measure. The risk assessment could set out both the prevailing view representing the "mainstream" of scientific opinion, as well as the opinions of scientists taking a divergent view. Article 5.1 does not require that the risk assessment must necessarily embody only the view of a majority of the relevant scientific community. In some cases, the very existence of divergent views presented by qualified scientists who have investigated the particular issue at hand may indicate a state of scientific uncertainty. Sometimes the divergence may indicate a roughly equal balance of scientific opinion, which may itself be a form of scientific uncertainty. In most cases, responsible and representative governments tend to base their legislative and administrative measures on "mainstream" scientific opinion. In other cases, equally responsible and representative governments may act in good faith on the basis of what, at a given time, may be a divergent opinion coming from qualified and respected sources. By itself, this does not necessarily signal the absence of a reasonable relationship between the SPS measure and the risk assessment, especially where the risk involved is life-threatening in character and is perceived to constitute a clear and imminent threat to public health and safety. Determination of the presence or absence of that relationship can only be done on a case-to-case basis, after account is taken of all considerations rationally bearing upon the issue of potential adverse health effects.

195. We turn now to the application by the Panel of the substantive requirements of Article 5.1 to the EC measures at stake in the present case. The Panel lists the following scientific material to which the European Communities referred in respect of the hormones here involved (except MGA):

- the 1982 Report of the EC Scientific Veterinary Committee, Scientific Committee for Animal Nutrition and the Scientific Committee for Food on the basis of the Report of the Scientific Group on Anabolic Agents in Animal Production ("Lamming Report");
- the 1983 Symposium on Anabolics in Animal Production of the Office international des epizooties ("OIE") ("1983 OIE Symposium");
- the 1987 Monographs of the International Agency for Research on Cancer ("IARC") on the Evaluation of Carcinogenic Risks to Humans, Supplement 7 ("1987 IARC Monographs");
- the 1988 and 1989 JECFA Reports;
- the 1995 European Communities Scientific Conference on Growth Promotion in Meat Production ("1995 EC Scientific Conference");
- articles and opinions by individual scientists relevant to the use of hormones (three articles in the Journal Science, one article in the International Journal of Health Service, one report in The Veterinary Record and separate scientific opinions of Dr. H. Adlercreutz, Dr. E. Cavaliere, Dr. S.S. Epstein, Dr. J.G. Liehr, Dr. M. Metzler, Dr. Perez-Comas and Dr. A. Pinter, all of whom were part of the EC delegation at [the] joint meeting with experts).<sup>177</sup>

196. Several of the above scientific reports appeared to the Panel to meet the minimum requirements of a risk assessment, in particular, the Lamming Report and the 1988 and 1989 JECFA Reports. The Panel assumes accordingly that the European Communities had demonstrated the existence of a risk assessment carried out in accordance with Article 5 of the SPS Agreement.<sup>178</sup> At the same time, the Panel finds that the conclusion of these scientific reports is that the use of the hormones at issue (except MGA) for growth promotion purposes is "safe". The Panel states:

... none of the scientific evidence referred to by the European Communities which specifically addresses the safety of some or all of the hormones in dispute when used for growth promotion, indicates that an identifiable risk arises for human health from such use of these hormones if good practice is followed. All of the scientific studies outlined above came to the conclusion that the use of the hormones at issue (all but MGA, for which no evidence was submitted)

<sup>177</sup>US Panel Report, para. 8.108; Canada Panel Report, para. 8.111.

<sup>178</sup>US Panel Report, para. 8.111; Canada Panel Report, para. 8.114.

<sup>176</sup>US Panel Report, para. 8.137; Canada Panel Report, para. 8.140.

for growth promotion purposes is safe; most of these studies adding that this conclusion assumes that good practice is followed.<sup>179</sup>

197. Prescinding from the difficulty raised by the Panel's use of the term "identifiable risk", we agree that the scientific reports listed above do not rationally support the EC import prohibition.<sup>180</sup>

198. With regard to the scientific opinion expressed by Dr. Lucier at the joint meeting with the experts, and as set out in paragraph 819 of the Annex to the US and Canada Panel Reports<sup>181</sup>, we should note that this opinion by Dr. Lucier does not purport to be the result of scientific studies carried out by him or under his supervision focusing specifically on residues of hormones in meat from cattle fattened with such hormones.<sup>182</sup> Accordingly, it appears that the single divergent opinion expressed by Dr. Lucier is not reasonably sufficient to overturn the contrary conclusions reached in the scientific studies referred to by the European Communities that related specifically to residues of the hormones in meat from cattle to which hormones had been administered for growth promotion.

199. The European Communities laid particular emphasis on the 1987 IARC Monographs and the articles and opinions of individual scientists referred to above.<sup>183</sup> The Panel notes, however, that the scientific evidence set out in these Monographs and these articles and opinions relates to the carcinogenic potential of entire categories of hormones, or of the hormones at issue in general. The Monographs and the articles and opinions are, in other words, in the nature of general studies of or statements on the carcinogenic potential of the named hormones. The Monographs and the articles and opinions of individual

<sup>179</sup>US Panel Report, para. 8.124; Canada Panel Report, para. 8.127.

<sup>180</sup>In paras. 97-109 of this Report, we conclude that the Panel mistakenly required that the European Communities take on the burden of proof that its measures related to the hormones involved here, except MGA, are based on a risk assessment. We determine that the United States and Canada have to make a prima facie case that these measures are not based on a risk assessment. However, after careful consideration of the panel record, we are satisfied that the United States and Canada, although not required to do so by the Panel, did, in fact, make this prima facie case that the SPS measures related to the hormones involved here, except MGA, are not based on a risk assessment.

<sup>181</sup>This paragraph reads in relevant part:

For every million women alive in the United States, Canada, Europe today, about 110,000 of those women will get breast cancer. This is obviously a tremendous public health issue. Of those 110,000 women get breast cancer, maybe several thousand of them are related to the total intake of exogenous oestrogens from every source, including eggs, meat, phyto-oestrogens, fungal oestrogens, the whole body burden of exogenous oestrogens. And by my estimates one of those 110,000 would come from eating meat containing oestrogens as a growth promoter, if used as prescribed.

<sup>182</sup>Assuming that Dr. Lucier's estimate is realistic, it is noteworthy that there could be up to 371 persons who, under the conditions identified by Dr. Lucier, would get cancer in the Member States of the European Union. The total population of the Member States of the European Union in 1995 was 371 million.

<sup>183</sup>Para. 195 of this Report.

scientists have not evaluated the carcinogenic potential of those hormones when used specifically for growth promotion purposes. Moreover, they do not evaluate the specific potential for carcinogenic effects arising from the presence in "food", more specifically, "meat or meat products" of residues of the hormones in dispute. The Panel also notes that, according to the scientific experts advising the Panel, the data and studies set out in these 1987 Monographs have been taken into account in the 1988 and 1989 JECFA Reports and that the conclusions reached by the 1987 IARC Monographs are complementary to, rather than contradictory of, the conclusions of the JECFA Reports.<sup>184</sup> The Panel concludes that these Monographs and these articles and opinions are insufficient to support the EC measures at issue in this case.

200. We believe that the above findings of the Panel are justified. The 1987 IARC Monographs and the articles and opinions of individual scientists submitted by the European Communities constitute general studies which do indeed show the existence of a general risk of cancer; but they do not focus on and do not address the particular kind of risk here at stake - the carcinogenic or genotoxic potential of the residues of those hormones found in meat derived from cattle to which the hormones had been administered for growth promotion purposes -- as is required by paragraph 4 of Annex A of the SPS Agreement. Those general studies, are in other words, relevant but do not appear to be sufficiently specific to the case at hand.

201. With regard to risk assessment concerning MGA, the European Communities referred to the 1987 IARC Monographs. These Monographs deal with, *inter alia*, the category of progestins of which the hormone progesterone is a member. The European Communities argues that because MGA is an anabolic agent which mimics the action of progesterone, the scientific studies and experiments relied on by the 1987 IARC Monographs were highly relevant.<sup>185</sup> However, the Monographs and the articles and opinions of the individual scientists did not include any study that demonstrated how closely related MGA is chemically and pharmacologically to other progestins and what effects MGA residues would actually have on human beings when such residues are ingested along with meat from cattle to which MGA has been administered for growth promotion purposes. It must be recalled in this connection that none of the other scientific material submitted by the European Communities referred to MGA, and that no international standard, guideline or recommendation has been developed by Codex relating specifically to MGA. The United States and Canada declined to submit any assessment of MGA upon the ground that the material they were aware of was proprietary and confidential in nature. In other words, there

<sup>184</sup>US Panel Report, para. 8.129; Canada Panel Report, para. 8.132.

<sup>185</sup>EC's appellant's submission, para. 179 ff.

was an almost complete absence of evidence on MGA in the panel proceedings. We therefore uphold the Panel's finding that there was no risk assessment with regard to MGA.

202. The evidence referred to above by the European Communities related to the biochemical risk arising from the ingestion by human beings of residues of the five hormones here involved in treated meat, where such hormones had been administered to the cattle in accordance with good veterinary practice.<sup>186</sup> The European Communities also referred to distinguishable but closely related risks - risks arising from failure to observe the requirements of good veterinary practice, in combination with multiple problems relating to detection and control of such abusive failure, in the administration of hormones to cattle for growth promotion.

203. The Panel considers this type of risk and examines the arguments made by the European Communities but finds no assessment of such kind of risk. Ultimately, the Panel rejects those arguments principally on a priori grounds. First, to the Panel, the provisions of Article 5.2 relating to "relevant inspection, sampling and testing methods":

... do not seem to cover the general problem of control (such as the problem of ensuring the observance of good practice) which can exist for any substance. The risks related to the general problem of control do not seem to be specific to the substance at issue but to the economic or social incidence related to a substance or its particular use (such as economic incentives for abuse). These non-scientific factors should, therefore not be taken into account in a risk assessment but in risk management.<sup>187</sup> (underlining added)

Moreover, the Panel finds that, assuming these factors could be taken into account in a risk assessment, the European Communities has not provided convincing evidence that the control or prevention of abuse of the hormones here involved is more difficult than the control of other veterinary drugs, the use of which is allowed in the European Communities. Further, the European Communities has not provided evidence that control would be more difficult under a regime where the use of the hormones in dispute is allowed

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<sup>186</sup> Although the term used in the Codex Standards for the three natural hormones is good animal husbandry practice (Section I, MRLs, Codex Alimentarius, Vol. 3, pp. 7, 12 and 14), the Glossary of Terms and Definitions of the Codex Alimentarius does not contain this term. Instead, it defines the concept:

"Good Practice in the Use of Veterinary Drugs (GPVD): Is the official recommended or authorized usage including withdrawal periods, approved by national authorities, of veterinary drugs under practical conditions".

We will therefore use the term good veterinary practice as a shorthand expression of the concept defined in the Codex Alimentarius.

<sup>187</sup> US Panel Report, para. 8.146; Canada Panel Report, para. 8.149.

under specific conditions than under the current EC regime of total prohibition both domestically and in respect of imported meat. The Panel concludes by saying that banning the use of a substance does not necessarily offer better protection of human health than other means of regulating its use.<sup>188</sup>

204. The European Communities appeals from these findings of the Panel principally on two grounds: firstly, that the Panel has misinterpreted Article 5.2 of the SPS Agreement; secondly, that the Panel has disregarded and distorted the evidence submitted by the European Communities.<sup>189</sup>

205. In respect of the first ground, we agree with the European Communities that the Panel has indeed misconceived the scope of application of Article 5.2. It should be recalled that Article 5.2 states that in the assessment of risks, Members shall take into account, in addition to "available scientific evidence", "relevant processes and production methods; [and] relevant inspection, sampling and testing methods". We note also that Article 8 requires Members to "observe the provisions of Annex C in the operation of control, inspection and approval procedures ...". The footnote in Annex C states that "control, inspection and approval procedures include, inter alia, procedures for sampling, testing and certification". We consider that this language is amply sufficient to authorize the taking into account of risks arising from failure to comply with the requirements of good veterinary practice in the administration of hormones for growth promotion purposes, as well as risks arising from difficulties of control, inspection and enforcement of the requirements of good veterinary practice.

206. Most, if not all, of the scientific studies referred to by the European Communities, in respect of the five hormones involved here, concluded that their use for growth promotion purposes is "safe"<sup>190</sup>, if the hormones are administered in accordance with the requirements of good veterinary practice. Where the condition of observance of good veterinary practice (which is much the same condition attached to the standards, guidelines and recommendations of Codex with respect to the use of the five hormones for growth promotion) is not followed, the logical inference is that the use of such hormones for growth promotion purposes may or may not be "safe".<sup>191</sup> The SPS Agreement requires assessment of the potential for adverse effects on human health arising from the presence of contaminants and toxins in food. We consider that the object and purpose of the SPS Agreement justify the examination and evaluation of all

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<sup>188</sup> US Panel Report, para. 8.146; Canada Panel Report, para. 8.149.

<sup>189</sup> EC's appellant's submission, para. 399 and 401.

<sup>190</sup> US Panel Report, para. 8.124; Canada Panel Report, para. 8.127.

<sup>191</sup> This point was clearly brought out during the oral hearing and both the United States and Canada expressed agreement with this inference. See footnote 186 of this Report concerning the usage of the terms "good veterinary practice" and "good animal husbandry practice".

such risks for human health whatever their precise and immediate origin may be. We do not mean to suggest that risks arising from potential abuse in the administration of controlled substances and from control problems need to be, or should be, evaluated by risk assessors in each and every case. When and if risks of these types do in fact arise, risk assessors may examine and evaluate them. Clearly, the necessity or propriety of examination and evaluation of such risks would have to be addressed on a case-by-case basis. What, in our view, is a fundamental legal error is to exclude, on an a priori basis, any such risks from the scope of application of Articles 5.1 and 5.2. We disagree with the Panel's suggestion that exclusion of risks resulting from the combination of potential abuse and difficulties of control is justified by distinguishing between "risk assessment" and "risk management". As earlier noted, the concept of "risk management" is not mentioned in any provision of the SPS Agreement and, as such, cannot be used to sustain a more restrictive interpretation of "risk assessment" than is justified by the actual terms of Article 5.2, Article 8 and Annex C of the SPS Agreement.

207. The question that arises, therefore, is whether the European Communities did, in fact, submit a risk assessment demonstrating and evaluating the existence and level of risk arising in the present case from abusive use of hormones and the difficulties of control of the administration of hormones for growth promotion purposes, within the United States and Canada as exporting countries, and at the frontiers of the European Communities as an importing country. Here, we must agree with the finding of the Panel that the European Communities in fact restricted itself to pointing out the condition of administration of hormones "in accordance with good practice" "without further providing an assessment of the potential adverse effects related to non compliance with such practice".<sup>192</sup> The record of the panel proceedings shows that the risk arising from abusive use of hormones for growth promotion combined with control problems for the hormones at issue, may have been examined on two occasions in a scientific manner. The first occasion may have occurred at the proceedings before the Committee of Inquiry into the Problem of Quality in the Meat Sector established by the European Parliament, the results of which constituted the basis of the Pimenta Report of 1989. However, none of the original studies and evidence put before the Committee of Inquiry was submitted to the Panel. The second occasion could have been the 1995 EC Scientific Conference on Growth Promotion in Meat Production. One of the three workshops of this Conference examined specifically the problems of "detection and control". However, only one of the studies presented to the workshop discussed systematically some of the problems arising from the combination of potential abuse and problems of control of hormones and other substances.<sup>193</sup> The study

presented a theoretical framework for the systematic analysis of such problems, but did not itself investigate and evaluate the actual problems that have arisen at the borders of the European Communities or within the United States, Canada and other countries exporting meat and meat products to the European Communities. At best, this study may represent the beginning of an assessment of such risks.

208. In the absence of any other relevant documentation, we find that the European Communities did not actually proceed to an assessment, within the meaning of Articles 5.1 and 5.2, of the risks arising from the failure of observance of good veterinary practice combined with problems of control of the use of hormones for growth promotion purposes. The absence of such a risk assessment, when considered in conjunction with the conclusion actually reached by most, if not all, of the scientific studies relating to the other aspects of risk noted earlier, leads us to the conclusion that no risk assessment that reasonably supports or warrants the import prohibition embodied in the EC Directives was furnished to the Panel. We affirm, therefore, the ultimate conclusion of the Panel that the EC import prohibition is not based on a risk assessment within the meaning of Articles 5.1 and 5.2 of the SPS Agreement and is, therefore, inconsistent with the requirements of Article 5.1.

209. Since we have concluded above<sup>194</sup> that an SPS measure, to be consistent with Article 3.3, has to comply with, *inter alia*, the requirements contained in Article 5.1, it follows that the EC measures at issue, by failing to comply with Article 5.1, are also inconsistent with Article 3.3 of the SPS Agreement.

## XII. The Reading of Article 5.5 of the SPS Agreement: Consistency of Levels of Protection and Resulting Discrimination or Disguised Restriction on International Trade

210. The European Communities also appeals from the conclusion of the Panel<sup>195</sup> that, by adopting arbitrary or unjustifiable distinctions in the levels of sanitary protection it considers appropriate in different situations which result in discrimination or a disguised restriction on international trade, the European Communities acted inconsistently with the requirements set out in Article 5.5 of the SPS Agreement.<sup>196</sup>

### A. General Considerations: the Elements of Article 5.5

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<sup>192</sup>See para. 177 of this Report.

<sup>193</sup>EC's appellant's submission, para. 448.

<sup>194</sup>US Panel Report, paras. 8.206, 8.218, 8.244, 8.266 and 8.269; Canada Panel Report, paras. 8.209, 8.221, 8.247, 8.269 and 8.272.

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<sup>192</sup>US Panel Report, para. 8.143; Canada Panel Report, para. 8.146.

<sup>193</sup>B. Jülicher, "Sampling Strategies", in Proceedings of the Scientific Conference on Growth Promotion in Meat Production, Brussels, 29 November to 1 December 1995, pp. 521-540.

211. Article 5.5 of the SPS Agreement needs to be quoted in full:

With the objective of achieving consistency in the application of the concept of appropriate level of sanitary or phytosanitary protection against risks to human life or health, or to animal and plant life or health, each Member shall avoid arbitrary or unjustifiable distinctions in the levels it considers to be appropriate in different situations, if such distinctions result in discrimination or a disguised restriction on international trade. Members shall cooperate in the Committee, in accordance with paragraphs 1, 2 and 3 of Article 12, to develop guidelines to further the practical implementation of this provision. In developing the guidelines, the Committee shall take into account all relevant factors, including the exceptional character of human health risks to which people voluntarily expose themselves.

212. Article 5.5 must be read in context. An important part of that context is Article 2.3 of the SPS Agreement, which provides as follows:

Members shall ensure that their sanitary and phytosanitary measures do not arbitrarily or unjustifiably discriminate between Members where identical or similar conditions prevail, including between their own territory and that of other Members. Sanitary and phytosanitary measures shall not be applied in a manner which would constitute a disguised restriction on international trade.

When read together with Article 2.3, Article 5.5 may be seen to be marking out and elaborating a particular route leading to the same destination set out in Article 2.3.

213. The objective of Article 5.5 is formulated as the "achieving [of] consistency in the application of the concept of appropriate level of sanitary or phytosanitary protection". Clearly, the desired consistency is defined as a goal to be achieved in the future. To assist in the realization of that objective, the Committee on Sanitary and Phytosanitary Measures is to develop guidelines for the practical implementation of Article 5.5, bearing in mind, among other things, that ordinarily, people do not voluntarily expose themselves to health risks. Thus, we agree with the Panel's view that the statement of that goal does not establish a legal obligation of consistency of appropriate levels of protection. We think, too, that the goal set is not absolute or perfect consistency, since governments establish their appropriate levels of protection frequently on an ad hoc basis and over time, as different risks present themselves at different times. It is only arbitrary or unjustifiable inconsistencies that are to be avoided.

214. Close inspection of Article 5.5 indicates that a complaint of violation of this Article must show the presence of three distinct elements. The first element is that the Member imposing the measure complained of has adopted its own appropriate levels of sanitary protection against risks to human life or health in several different situations. The second element to be shown is that those levels of protection exhibit arbitrary or unjustifiable differences ("distinctions" in the language of Article 5.5) in their treatment of different situations. The last element requires that the arbitrary or unjustifiable differences result in discrimination or a disguised restriction of international trade. We understand the last element to be referring to the measure embodying or implementing a particular level of protection as resulting, in its application, in discrimination or a disguised restriction on international trade.

215. We consider the above three elements of Article 5.5 to be cumulative in nature; all of them must be demonstrated to be present if violation of Article 5.5 is to be found. In particular, both the second and third elements must be found. The second element alone would not suffice. The third element must also be demonstrably present: the implementing measure must be shown to be applied in such a manner as to result in discrimination or a disguised restriction on international trade. The presence of the second element -- the arbitrary or unjustifiable character of differences in levels of protection considered by a Member as appropriate in differing situations -- may in practical effect operate as a "warning" signal that the implementing measure in its application might be a discriminatory measure or might be a restriction on international trade disguised as an SPS measure for the protection of human life or health. Nevertheless, the measure itself needs to be examined and appraised and, in the context of the differing levels of protection, shown to result in discrimination or a disguised restriction on international trade.

#### B. Different Levels of Protection in Different Situations

216. We examine the first element set out in Article 5.5, namely, that a Member has established different levels of protection which it regards as appropriate for itself in differing situations. The Panel, interpreting the term "different situations", states in effect that situations involving the same substance or the same adverse health effect may be compared to one another.<sup>197</sup> The European Communities protests this interpretation as erroneous: while it agrees that there must be some common element (e.g. the substance or drug, or the health risk), it argues that such common element is not necessarily sufficient to ensure a rational comparison.<sup>198</sup>

<sup>197</sup>US Panel Report, para. 8.176; Canada Panel Report, para. 8.179.

<sup>198</sup>EC's appellant's submission, para. 455.

217. There appears no need to examine this matter at any length. Clearly, comparison of several levels of sanitary protection deemed appropriate by a Member is necessary if a panel's inquiry under Article 5.5 is to proceed at all. The situations exhibiting differing levels of protection cannot, of course, be compared unless they are comparable, that is, unless they present some common element or elements sufficient to render them comparable. If the situations proposed to be examined are totally different from one another, they would not be rationally comparable and the differences in levels of protection cannot be examined for arbitrariness.

218. In examining the EC measures here involved<sup>199</sup> and at least one other SPS measure of the European Communities<sup>200</sup>, the Panel finds that several different levels of protection were projected by the European Communities:

- (i) the level of protection in respect of natural hormones when used for growth promotion<sup>201</sup>;
- (ii) the level of protection in respect of natural hormones occurring endogenously in meat and other foods<sup>202</sup>;
- (iii) the level of protection in respect of natural hormones when used for therapeutic or zootechnical purposes<sup>203</sup>;
- (iv) the level of protection in respect of synthetic hormones (zeranol and trenbolone) when used for growth promotion<sup>204</sup>; and
- (v) the level of protection in respect of carbadox and olaquinox<sup>205</sup>.

C. Arbitrary or Unjustifiable Differences in Levels of Protection

219. The Panel then proceeds to compare level of protection (i) with, firstly, level of protection (ii) and, secondly, with level of protection (iii). Thereafter, the Panel compares levels of protection (i) and

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<sup>199</sup>See paras. 2-5 of this Report.

<sup>200</sup>Directive du Conseil 70/524/CEE of 23 November 1970, Official Journal No. L 270, 14 December 1970, p. 1, the Annexes of which are replaced by Commission Directive 91/248/EEC of 12 April 1991, Official Journal No. L 124, 18 May 1991, p. 1.

<sup>201</sup>US Panel Report, para. 8.191; Canada Panel Report, para. 8.194; and, with regard to MGA, US Panel Report, para. 8.265; Canada Panel Report, para. 8.268.

<sup>202</sup>US Panel Report, para. 8.191; Canada Panel Report, para. 8.194; and, with regard to MGA, US Panel Report, para. 8.265; Canada Panel Report, para. 8.268.

<sup>203</sup>US Panel Report, para. 8.191; Canada Panel Report, para. 8.194.

<sup>204</sup>US Panel Report, para. 8.212; Canada Panel Report, para. 8.215.

<sup>205</sup>US Panel Report, para. 8.226 (with respect to carbadox only); Canada Panel Report, para. 8.229; and, with regard to MGA, US Panel Report, para. 8.268; Canada Panel Report, para. 8.271.

(iv) with level of protection (v). The Panel holds that the differences between levels of protection (i) and (iv) on the one hand, and level of protection (ii) on the other, are arbitrary and unjustifiable.<sup>206</sup> It further held that the differences in levels of protection (i) and (iv) on the one hand, and level (v) on the other, are also arbitrary and unjustifiable.<sup>207</sup> In contrast, the Panel does not undertake to compare level of protection (iii) with level of protection (i).<sup>208</sup> We examine below *seriatim* what the Panel has done and the results it has obtained.

220. The Panel first compares the levels of protection established by the European Communities in respect of natural and synthetic hormones when used for growth promotion purposes (levels of protection (i) and (iv)) with the level of protection set by the European Communities in respect of natural hormones occurring endogenously in meat and other natural foods (level of protection (ii)). The Panel finds the difference between these levels of protection "arbitrary" and "unjustifiable" basically because, in its view, the European Communities had not provided any reason other than the difference between added hormones and hormones naturally occurring in meat and other foods that have formed part of the human diet for centuries, and had not submitted any evidence that the risk related to natural hormones used as growth promoters is higher than the risk related to endogenous hormones.<sup>209</sup> The Panel adds that the residue level of natural hormones in some natural products (such as eggs and broccoli) is higher than the residue level of hormones administered for growth promotion in treated meat.<sup>210</sup> Furthermore, the Panel states the practical difficulties of detecting the presence of residues of natural hormones in treated meat would also be present in respect of natural hormones occurring endogenously in meat and other foods.<sup>211</sup> The Panel stresses the very marked gap between a "no-residue" level of protection against natural hormones used for growth promotion and the "unlimited-residue" level of protection with regard to hormones occurring naturally in meat and other foods.<sup>212</sup> Much the same reasons are deployed by the Panel in comparing the levels of protection in respect of synthetic hormones used for growth promotion and in respect of natural hormones endogenously occurring in meat and other foods.<sup>213</sup>

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<sup>206</sup>US Panel Report, paras. 8.197 and 8.214; Canada Panel Report, paras. 8.200 and 8.217; and, with regard to MGA, US Panel Report, para. 8.265; Canada Panel Report, para. 8.268.

<sup>207</sup>US Panel Report, para. 8.238; Canada Panel Report, para. 8.241; and, with regard to MGA, US Panel Report, para. 8.268; Canada Panel Report, para. 8.271.

<sup>208</sup>US Panel Report, para. 8.200; Canada Panel Report, para. 8.203.

<sup>209</sup>US Panel Report, para. 8.193; Canada Panel Report, para. 8.196.

<sup>210</sup>US Panel Report, para. 8.194; Canada Panel Report, para. 8.197.

<sup>211</sup>US Panel Report, para. 8.195; Canada Panel Report, para. 8.198.

<sup>212</sup>US Panel Report, para. 8.196; Canada Panel Report, para. 8.199.

<sup>213</sup>US Panel Report, paras. 8.213, 8.264 and 8.265; Canada Panel Report, paras. 8.216, 8.267 and 8.268.

221. We do not share the Panel's conclusions that the above differences in levels of protection in respect of added hormones in treated meat and in respect of naturally-occurring hormones in food, are merely arbitrary and unjustifiable. To the contrary, we consider there is a fundamental distinction between added hormones (natural or synthetic) and naturally-occurring hormones in meat and other foods. In respect of the latter, the European Communities simply takes no regulatory action<sup>214</sup>, to require it to prohibit totally the production and consumption of such foods or to limit the residues of naturally-occurring hormones in food, entails such a comprehensive and massive governmental intervention in nature and in the ordinary lives of people as to reduce the comparison itself to an absurdity. The other considerations cited by the Panel, whether taken separately or grouped together, do not justify the Panel's finding of arbitrariness in the difference in the level of protection between added hormones for growth promotion and naturally-occurring hormones in meat and other foods.

222. Because the Panel finds that the difference in the level of protection in respect of the three natural hormones, when used for growth promotion purposes, and the level of protection in respect of natural hormones present endogenously in meat and other foods is unjustifiable, the Panel regards it as unnecessary to decide whether the difference in the levels of protection set by the European Communities in respect of natural hormones used as growth promoters and in respect of the same hormones when used for therapeutic or zootechnical purposes, is justified.<sup>215</sup> Because, however, we have reached a conclusion different from that of the Panel, we consider it appropriate to complete the Panel's analysis in order that we may be in a position to review the Panel's conclusion concerning consistency with Article 5.5 as a whole. The matter of therapeutic and zootechnical uses of hormones was fully argued before the Panel.<sup>216</sup> Although the failure of the Panel to proceed with this comparison was not expressly appealed by the United States, the United States relies markedly upon the fact that the European Communities treats therapeutic and zootechnical uses of natural hormones differently from growth promotion use of the same hormones.<sup>217</sup>

223. The European Communities has argued that there are two important differences between the administration of hormones for growth promotion purposes and their administration for therapeutic and zootechnical purposes. The first difference concerns the frequency and scale of the treatment.<sup>218</sup>

<sup>214</sup>It may be questioned whether the European Communities has established at all an appropriate level of protection in respect of naturally-occurring hormones in meat and other foods (i.e. which are part of peoples' daily diet). We have accepted arguendo the assumption of the Panel that the European Communities did, for the purposes of this analysis.

<sup>215</sup>US Panel Report, para. 8.200; Canada Panel Report, para. 8.203.

<sup>216</sup>See, for example, US Panel Report, paras. 4.63, 4.64, 4.68, 4.69, 4.71, 4.223, 4.224, 4.225, 4.226 and 4.227, and Canada Panel Report, paras. 4.141, 4.147, 4.217, 4.238 and 4.242.

<sup>217</sup>United States' appellant's submission, paras. 26, 27 and 29.

<sup>218</sup>EC's appellee's submission, paras. 82-84.

Therapeutic use is occasional as opposed to regular and continuous use that characterizes growth promotion.<sup>219</sup> Therapeutic use is selective as it concerns only individual sick or diseased animals; growth promotion involves the administration of hormones to all herds and all the members of a herd of cattle. Thus, therapeutic use takes place on a small scale and normally involves cattle intended for breeding and not for slaughter; in contrast, the use of these hormones for growth promotion occurs on a much larger scale and is much more difficult and costly to control.<sup>220</sup> Zootechnical use may relate to entire herds but would occur only once a year<sup>221</sup>; it is thus clearly distinguishable from the use of hormones continuously and over long periods of time (apparently most of the lifespan of the animals involved). This difference has been stressed in particular by Dr. André, one of the experts advising the Panel.<sup>222</sup>

224. The second difference concerns the mode of administration of hormones. In order to prevent abuse<sup>223</sup>, the European Communities has regulated in substantial detail the conditions under which the administration of natural hormones may be authorized by the Member States of the European Union for therapeutic and zootechnical purposes. The hormones must, in the first place, be administered by a veterinarian or under the responsibility of a veterinarian.<sup>224</sup> In addition, Directive 96/22/EC specifies detailed conditions, such as, for example: strict withdrawal periods; administration by injection or, in case of varying disfunctions, by vaginal spirals, but not by implants; clear identification of the individual animal so treated; and recording of the details of treatment by the responsible veterinarian (e.g. type of treatment, type of veterinary drug used or authorized, date of treatment, identity of the animals treated).<sup>225</sup>

225. The conclusion we come to, after consideration of the foregoing factors, is that, on balance, the difference in the levels of protection concerning hormones used for growth promotion purposes, on the one hand, and concerning hormones used for therapeutic and zootechnical purposes, on the other, is not, in itself, "arbitrary or unjustifiable".

<sup>219</sup>US Panel Report, para. 4.71; Canada Panel Report, para. 4.242.

<sup>220</sup>US Panel Report, para. 8.198; Canada Panel Report, para. 8.201.

<sup>221</sup>US Panel Report, para. 8.199; Canada Panel Report, para. 8.202.

<sup>222</sup>US Panel Report, paras. 6.183, 6.184 and 6.189; Canada Panel Report, paras. 6.182, 6.183 and 6.188.

<sup>223</sup>See the ninth paragraph of the Preamble of Directive 96/22/EC, dated 29 April 1996, which states:  
Whereas the prohibition on the use of hormonal substances for fattening purposes should continue to apply; whereas the use of certain substances for therapeutic or zootechnical purposes may be authorized but must be strictly controlled in order to prevent any misuse;  
(underlining added)

<sup>224</sup>US Panel Report, para. 4.69; Canada Panel Report, para. 4.192.

<sup>225</sup>US Panel Report, para. 4.69; Canada Panel Report, para. 4.238.

226. We turn to the Panel's comparison between the levels of protection set by the European Communities in respect of natural and synthetic hormones for growth promotion and with respect to carbadox and olaquinox. <sup>226</sup> Carbadox and olaquinox are anti-microbial agents or compounds which are mixed with the feed given to piglets (maximum age of four months). According to a report of JECFA <sup>227</sup>, submitted to the Panel by the United States, carbadox is a feed additive that is a known genotoxic carcinogen, that is, carbadox induces and does not merely promote cancer. <sup>228</sup> The experts advising the Panel confirmed that carbadox was genotoxic in character.

227. In the panel proceedings, the European Communities sought to justify the difference in the levels of protection in respect of the natural and synthetic hormones (except MGA) and in respect of carbadox and olaquinox. <sup>229</sup> The Panel responds to these arguments and the European Communities has reiterated its original arguments in its appellant's submission. <sup>230</sup> We canvass the arguments of the European Communities and the Panel's responses, which are set out below in very summary form.

228. The first argument of the European Communities is that carbadox and olaquinox are not hormones, but rather anti-microbial agents. The Panel responds that the European Communities has not explained why this difference would itself justify a different regulatory treatment in the light of the carcinogenic potential of both kinds of substances. <sup>231</sup>

229. The second argument of the European Communities is that carbadox and olaquinox only indirectly act as growth promoters by suppressing the development of bacteria and aiding the intestinal flora of piglets, thereby also exerting preventive therapeutic effects; hormones, it is said, have no preventive therapeutic action when used as growth promoters. However, the Panel considers that both the hormones in dispute and carbadox and olaquinox may have therapeutic effects. <sup>232</sup>

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<sup>226</sup>EC Directive 70/524/CEE of 23 November 1970 governs the use of additives to animal feed. This Directive allows Member States to permit the use of certain additives listed in Annex I of the Directive, under the conditions there specified. On 12 April 1991, EC Directive 91/248/EEC replaced Annexes I and II of the 1970 Directive with new Annexes. The new Annex I includes the following under the subheading "growth promoters": carbadox and olaquinox.

<sup>227</sup>Evaluation of Certain Veterinary Drug Residues in Food: Thirty-sixth Report of the Joint FAO/WHO Expert Committee on Food Additives ("JECFA"), Technical Report Series 799 (World Health Organization, 1990), pp. 45-50.

<sup>228</sup>US Panel Report, para. 4.220.

<sup>229</sup>US Panel Report, para. 8.229 (with respect to carbadox only); Canada Panel Report, para. 8.232.

<sup>230</sup>EC's appellant's submission, paras. 528-548.

<sup>231</sup>US Panel Report, para. 8.231 (with respect to carbadox only); Canada Panel Report, para. 8.234.

<sup>232</sup>US Panel Report, para. 8.232 (with respect to carbadox only); Canada Panel Report, para. 8.235.

230. The European Communities' third argument is that carbadox and olaquinox are only commercially available in prepared feedstuffs (not as injections or implants) in predetermined dosages and, therefore, are less open to abuse. The Panel observes that, according to experts advising it, products containing any of the five hormones at issue for implantation or injection are also packaged in predetermined dosages. The experts add that carbadox as an additive in feedstuffs poses additional risks since it may harm the persons handling the feedstuff. <sup>233</sup>

231. The fourth argument of the European Communities is that there are no alternatives to carbadox or olaquinox available that have the same therapeutic action. The Panel notes that, according to one of the experts, there are readily available alternatives such as oxytetracycline. According to Canada, oxytetracycline has been the subject of a risk assessment by JECFA and Codex has adopted the Acceptable Daily Intakes (ADI) and MRLs recommended by JECFA. <sup>234</sup>

232. The European Communities' fifth argument is that carbadox cannot be abused since it has growth promotion effects only in piglets up to four months old and a fixed withdrawal period of at least 28 days is set in the relevant Directive. In turn, the Panel notes that, according to its expert advisors, there is no assurance that the piglets treated with carbadox would not be slaughtered and that residues of carbadox would not thereby enter the food chain of human beings. The Panel adds that the use of the hormones at issue as growth promoters could similarly be subjected to strict conditions. <sup>235</sup>

233. The sixth argument the European Communities made is that carbadox is used in very small quantities and is hardly absorbed in the piglet's gut with the result that it leaves practically no residues at all in pork meat destined for human consumption. The Panel replies that, according to the experts advising it, once a substance has been administered to an animal, there will always be some residue of this substance or a metabolite left, albeit a very small amount, in the meat of that animal. <sup>236</sup> In this connection, Canada volunteered the comment that, according to a 1991 study commissioned by the European Communities and provided to the Panel, metabolites of carbadox and olaquinox are "nearly completely absorbed in the gut" and that "in using carbadox, a mutagenic or carcinogenic risk for the consumer seems negligible if the withdrawal time is closely respected". <sup>237</sup>

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<sup>233</sup>US Panel Report, para. 8.233 (with respect to carbadox only); Canada Panel Report, para. 8.236.

<sup>234</sup>US Panel Report, para. 8.234 (with respect to carbadox only); Canada Panel Report, para. 8.237.

<sup>235</sup>US Panel Report, para. 8.235; Canada Panel Report, para. 8.238.

<sup>236</sup>US Panel Report, para. 8.236; Canada Panel Report, para. 8.239.

<sup>237</sup>CEAS Consultants (Wye) Ltd. (et al.), *The Impact on Animal Husbandry in the European Community of the Use of Growth Promoters*, Final Report, Vol. I (1991), cited in Canada's appellee's submission, paras. 180-181.

We consider the reasoning in both Appellate Body Reports to be equally relevant to the relationship between the three elements contained in Article 5.5. All three elements impart meaning to one another. Nevertheless, in order to give effect to all three elements contained in Article 5.5 and giving full meaning to the text and context of this provision, we consider that all three elements need to be distinguished and addressed separately. However, we also agree that in some cases where a Member enacts, for comparable situations, sanitary measures which reflect different levels of protection, the significance of the difference in levels of protection combined with the arbitrariness thereof may be sufficient to conclude that this difference in levels of protection "result[s] in discrimination or a disguised restriction on international trade" in the sense of Article 5.5 (in line with the argument that the magnitude of the very differential of a dissimilar taxation may be enough to conclude that a dissimilar taxation is applied so as to afford protection, as provided for in the second sentence of Article III:2 of GATT.<sup>244</sup> (underlining added)

237. The European Communities urges that the Panel committed several errors of legal interpretation. Firstly, the Panel disregards the alternative character of the three elements of the chapeau of Article XX of the GATT 1994, and the fact that the three elements of Article 5.5 of the SPS Agreement are additional and cumulative in nature.<sup>245</sup> Secondly, Article III:2, second sentence, of the GATT 1994 is concerned with the impact of a tax on the competitive relations concerning directly competitive or substitutable products. On the other hand, discrimination and disguised restriction in the sense of Article 5.5 of the SPS Agreement are entirely different concepts.<sup>246</sup> Thirdly, and as a consequence of its interpretation of Article 5.5, a "discrimination or a disguised restriction on international trade" is not really, for the Panel, a third or additional requirement at all under Article 5.5.<sup>247</sup>

238. We agree with the Panel's view that "all three elements [of Article 5.5] need to be distinguished and addressed separately".<sup>248</sup> We also recall our interpretation that Article 5.5 and, in particular, the terms "discrimination or a disguised restriction on international trade", have to be read in the context of the basic obligations contained in Article 2.3, which requires that "sanitary ... measures shall not be applied in a manner which would constitute a disguised restriction on international trade". (emphasis added)<sup>249</sup>

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<sup>244</sup>US Panel Report, para. 8.184; Canada Panel Report, para. 8.187.

<sup>245</sup>EC's appellant's submission, paras. 471-477.

<sup>246</sup>EC's appellant's submission, para. 486.

<sup>247</sup>EC's appellant's submission, para. 491.

<sup>248</sup>US Panel Report, para. 8.184; Canada Panel Report, para. 8.187.

<sup>249</sup>See para. 212 of this Report.

234. The European Communities made a seventh argument which was not repeated in its appeal: the complaining parties limit their claim to one or two substances out of 10,000 to 15,000 veterinary medicinal substances the use of which the European Communities authorizes, which indicates "a remarkable degree of consistency in its levels of sanitary protection".<sup>238</sup> The Panel notes that the European Communities has advised it that the EC Council, by a Decision of 26 February 1996, has already taken action *motu proprio* to review carbadox and olaquinox. To the Panel, the arguments of the European Communities suggest that it acknowledges that the difference in the levels of protection in respect of added hormones and in respect of carbadox and olaquinox may not be justified and should be reviewed.<sup>239</sup>

235. Having reviewed the above arguments and counter-arguments, we must agree with the Panel that the difference in the EC levels of protection in respect of the hormones in dispute when used for growth promotion, on the one hand, and carbadox and olaquinox, on the other, is unjustifiable in the sense of Article 5.5.

#### D. Resulting in Discrimination or a Disguised Restriction on International Trade

236. In interpreting this last element or requirement of Article 5.5, the Panel recalls the conclusion of the Appellate Body in *United States - Standards for Reformulated and Conventional Gasoline*<sup>240</sup> ("*United States - Gasoline*") to the effect that the terms "arbitrary discrimination", "unjustifiable discrimination" and "disguised restriction on international trade" found in Article XX of the GATT 1994, may be read side-by-side and impart meaning to one another.<sup>241</sup> The Panel also recalls our statement in *Japan - Alcoholic Beverages*<sup>242</sup>, and in particular the requirement in Article III:2, second sentence, of the GATT 1994 that dissimilar taxation needs to be "applied ... so as to afford protection to domestic production". It quotes the passage stating, in part, that "[t]he dissimilar taxation] may be so much more that it will be clear from that very differential that the dissimilar taxation was applied so as to afford protection". In some cases, that may be enough to show a violation".<sup>243</sup> The Panel then renders its interpretation of the last requirement of Article 5.5 of the SPS Agreement as follows:

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<sup>238</sup>US Panel Report, para. 8.237; Canada Panel Report, para. 8.240.

<sup>239</sup>US Panel Report, para. 8.237 (with respect to carbadox only); Canada Panel Report, para. 8.240.

<sup>240</sup>Adopted 20 May 1996, WT/DS2/AB/R.

<sup>241</sup>US Panel Report, paras. 8.182 and 8.240; Canada Panel Report, paras. 8.185 and 8.243.

<sup>242</sup>Adopted 1 November 1996, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R.

<sup>243</sup>US Panel Report, para. 8.183; Canada Panel Report, para. 8.186.

239. However, we disagree with the Panel on two points. First, in view of the structural differences between the standards of the chapeau of Article XX of the GATT 1994 and the elements of Article 5.5 of the SPS Agreement, the reasoning in our Report in United States - Gasoline, quoted by Panel, cannot be casually imported into a case involving Article 5.5 of the SPS Agreement. Secondly, in our view, it is similarly unjustified to assume applicability of the reasoning of the Appellate Body in Japan - Alcoholic Beverages<sup>250</sup> about the inference that may be drawn from the sheer size of a tax differential for the application of Article III:2, second sentence, of the GATT 1994, to the quite different question of whether arbitrary or unjustifiable differences in levels of protection against risks for human life or health, "result in discrimination or a disguised restriction on international trade"<sup>251</sup>.

240. In our view, the degree of difference, or the extent of the discrepancy, in the levels of protection, is only one kind of factor which, along with others, may cumulatively lead to the conclusion that discrimination or a disguised restriction on international trade in fact results from the application of a measure or measures embodying one or more of those different levels of protection. Thus, we do not think that the difference between a "no residues" level and "unlimited residues" level is, together with a finding of an arbitrary or unjustifiable difference, sufficient to demonstrate that the third, and most important, requirement of Article 5.5 has been met. It is well to bear in mind that, after all, the difference in levels of protection that is characterizable as arbitrary or unjustifiable is only an element of (indirect) proof that a Member may actually be applying an SPS measure in a manner that discriminates between Members or constitutes a disguised restriction on international trade, prohibited by the basic obligations set out in Article 2.3 of the SPS Agreement. Evidently, the answer to the question whether arbitrary or unjustifiable differences or distinctions in levels of protection established by a Member do in fact result in discrimination or a disguised restriction on international trade must be sought in the circumstances of each individual case.

241. In the present appeal, it is necessary to address this question only with regard to the difference in the levels of protection established in respect of the hormones in dispute and in respect of carbox and olaquinox.

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<sup>250</sup>Adopted 1 November 1996, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R.

<sup>251</sup>The differential involved in Japan - Alcoholic Beverages was a tax differential, which is very different from a differential in levels of protection. Unlike a differential in levels of protection, a tax differential is always expressed in quantitative terms and a significant tax differential in favour of domestic products will inevitably affect the competitiveness of imported products and thus afford protection to domestic products. There is a clear and linear relationship between a tax differential and the protection afforded to domestic products. There is, however, no such relationship between a differential in levels of human health protection and discrimination or disguised restriction on trade.

242. According to the Panel, the "significance" of the "arbitrary or unjustifiable" distinction in the level of protection concerning the hormones in dispute as compared with the level of protection in respect of carbox and olaquinox results in discrimination or a disguised restriction on international trade. It bases this finding on: (i) the great difference in the levels of protection, namely, the difference between a "no residue" level for the five hormones at issue when used as growth promoters, as opposed to an "unlimited residue" level for carbox and olaquinox; (ii) the absence of any plausible justification put forward by the European Communities for this significant difference; and (iii) the nature of the EC measure, i.e., the prohibition of imports, which necessarily restricts international trade.<sup>252</sup>

243. The Panel adduces, in support of its finding, three additional factors: (iv) the objectives (apart from the protection of human health) that it believes the European Communities had in mind in enacting or maintaining the EC ban, as reflected in the preambles of the measures in dispute, the reports of the European Parliament and the opinions rendered by the EC Social and Economic Committee. These include the harmonizing of the regulatory schemes of the different Member States of the European Union and the removal of competitive distortions in and barriers to intra-community trade in beef, and the bringing about of an increase in the consumption of beef, thereby reducing the internal beef surpluses, and providing more favourable treatment to domestic producers<sup>253</sup>; (v) before the import ban came into force (in 1987), the percentage of animals treated for growth promotion with the hormones in dispute was significantly lower in the European Communities than in Canada and the United States. The apparent implication, for the Panel, is that the EC measures constitute de facto discrimination against imported beef produced with growth promotion hormones<sup>254</sup>; and (vi) that the hormones at issue are used for growth promotion in the bovine sector "where the European Communities seemingly wants to limit supplies and is arguably less concerned with international competitiveness", whereas carbox and olaquinox are used for growth promotion in the pork meat sectors "where the European Communities has no domestic surpluses and where international competitiveness is a higher priority"<sup>255</sup>.

244. In its appeal, the European Communities stresses that the prohibition of the use of hormones for growth promotion purposes applies equally to beef produced within the European Communities and to imports of such beef.<sup>256</sup> It is also emphasized that the predominant motivation for both the prohibition

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<sup>252</sup>US Panel Report, para. 8.241; Canada Panel Report, para. 8.244.

<sup>253</sup>US Panel Report, para 8.242; Canada Panel Report, para. 8.245.

<sup>254</sup>US Panel Report, para 8.242; Canada Panel Report, para. 8.245.

<sup>255</sup>US Panel Report, para. 8.243 (with respect to carbox only); Canada Panel Report, para. 8.246.

<sup>256</sup>EC's appellant's submission, para. 552.

of the domestic use of growth promotion hormones and the prohibition of importation of treated meat, is the protection of the health and safety of its population. No suggestion has been made that the import prohibition of treated meat was the result of lobbying by EC domestic producers of beef. It is also pointed out that legislation (in representative governments) normally reflects multiple objectives. The fact that there was a higher percentage of beef treated with growth promotion hormones in Canada and in the United States, as compared with the European Communities, was simply a reflection of the fact that Canada and the United States had allowed this practice for a long time while the European Communities had not. The long history of the EC Directives should be recalled in this connection. The import prohibition could not have been designed simply to protect beef producers in the European Communities vis-à-vis beef producers in the United States and Canada, for beef producers in the European Communities were precisely forbidden to use the same hormones for the same purpose. We note, in this connection, that the prohibition of domestic use also necessarily excludes any exports of treated meat by domestic producers.

245. We do not attribute the same importance as the Panel to the supposed multiple objectives of the European Communities in enacting the EC Directives that set forth the EC measures at issue. The documentation that preceded or accompanied the enactment of the prohibition of the use of hormones for growth promotion and that formed part of the record of the Panel makes clear the depth and extent of the anxieties experienced within the European Communities concerning the results of the general scientific studies (showing the carcinogenicity of hormones), the dangers of abuse (highlighted by scandals relating to black-marketing and smuggling of prohibited veterinary drugs in the European Communities) of hormones and other substances used for growth promotion and the intense concern of consumers within the European Communities over the quality and drug-free character of the meat available in its internal market.<sup>257</sup> A major problem addressed in the legislative process of the European Communities related to the differences in the internal regulations of various Member States of the European Union (four or five of which permitted, while the rest prohibited, the use for growth promotion of certain hormones), the resulting distortions in competitive conditions in and the existence of barriers to intra-community trade. The necessity for harmonizing the internal regulations of its Member States was a consequence

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<sup>257</sup> See, for example: Opinion of the Economic and Social Committee of 13 December 1984 on the proposal for a Council Directive amending Directive 81/602/EEC concerning the prohibition of certain substances having a hormonal action and of any substances having a thyrostatic action, Official Journal, No. C 44, 15 February 1985, p. 14; Resolution of the European Parliament of 11 October 1985 on the proposal for a Council Directive amending Directive 81/602/EEC concerning the prohibition of certain substances having a hormonal action and of any substances having a thyrostatic action, Official Journal, No. C 288, 11 November 1985, p. 158; Resolution of the European Parliament of 16 September 1988 on the use of hormones in meat production, Official Journal, No. C 262, 10 October 1988, p. 167; and Resolution of the European Parliament of 14 April 1989 on the USA's refusal to comply with Community legislation on slaughterhouses and hormones, and the consequences of this refusal, Official Journal, No. C 120, 16 May 1989, p. 356. The latter Resolution was based on, inter alia, the Pimenta Report, Paris A and B.

of the European Communities' mandate to establish a common (internal) market in beef.<sup>258</sup> Reduction of any beef surplus through an increase in the consumption of beef within the European Communities, is not only in the interests of EC farmers, but also of non-hormone using farmers in exporting countries. We are unable to share the inference that the Panel apparently draws that the import ban on treated meat and the Community-wide prohibition of the use of the hormones here in dispute for growth promotion purposes in the beef sector were not really designed to protect its population from the risk of cancer, but rather to keep out US and Canadian hormone-treated beef and thereby to protect the domestic beef producers in the European Communities.

246. Our conclusion, therefore, is that the Panel's finding that the "arbitrary or unjustifiable" difference in the EC levels of protection in respect of the hormones at issue on the one hand and in respect of carbox and olaquinox on the other hand, "result in discrimination or a disguised restriction on international trade", is not supported either by the architecture and structure of the EC Directives here at stake or of the subsequent Directive on carbox and olaquinox, or by the evidence submitted by the United States and Canada to the Panel. The Panel's finding is itself unjustified and erroneous as a matter of law. Accordingly, we reverse the conclusion of the Panel that the European Communities has acted inconsistently with the requirements set out in Article 5.5 of the SPS Agreement.

XIII. Appeals by the United States and Canada: Articles 2.2 and Article 5.6 of the SPS Agreement

247. The Panel refrained from making findings under Articles 2.2 and 5.6 of the SPS Agreement. In respect of Article 2.2, the Panel, having found that the EC measures are inconsistent with Articles 3.1, 5.1 and 5.5, did not believe there was any necessity for making a finding on the consistency of the same EC measures with Article 2.2. The Panel, in so concluding, also considered that Articles 3 and 5 provide for more specific rights and obligations than the "basic rights and obligations" set out in Article 2.<sup>259</sup>

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<sup>258</sup> Article 7a of the Treaty Establishing the European Community stipulates:

The Community shall adopt measures with the aim of progressively establishing the internal market over a period expiring on 31 December 1992 ... The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty.

<sup>259</sup> US Panel Report, para 8.271; Canada Panel Report, para. 8.274.

248. In respect of Article 5.6, the Panel held that since it had already found the EC level of protection reflected in the EC measure in dispute was adopted in violation of Article 5.5, there was no need to examine whether that same measure is also more trade restrictive than necessary to achieve that level in the sense of Article 5.6.<sup>260</sup>

249. The United States, qua appellant, believes the Panel has made all the findings necessary for the purpose and should have declared the EC import prohibition inconsistent with Article 2.2.<sup>261</sup> It is also submitted by the United States that the text of Articles 2, 3 and 5 does not indicate that all of the obligations in Article 2.2 are subsumed under Articles 3 and 5.<sup>262</sup> In respect of Article 5.6, it is similarly urged by the United States that the Panel's findings on Article 5.5 are sufficient to establish that the EC import prohibition is also inconsistent with Article 5.6.<sup>263</sup> Similar submissions are made by Canada as appellant.<sup>264</sup>

250. We agree with the Panel's application of the notion of judicial economy. We have affirmed the Panel's conclusion that the EC measures are inconsistent with Article 5.1 in view of the failure of the European Communities to provide a risk assessment that reasonably supports such measures. Under the circumstances, the necessity or propriety of proceeding to determine whether Article 2.2 of the SPS Agreement has also been violated is not at all clear to us. Had we reversed the Panel's conclusion in respect of the inconsistency of the EC measures with Article 5.1, it would have been logically necessary to inquire whether Article 2.2 might nevertheless have been violated. We are, of course, surprised by the fact that the Panel did not begin its analysis of this whole case by focusing on Article 2 that is captioned "Basic Rights and Obligations", an approach that appears logically attractive. We recall the reading that we have given above to Articles 2 and 5 -- that Article 2.2 informs Article 5.1, and that similarly Article 2.3 informs Article 5.5 -- but believe that further analysis of their relationship should await another case.

251. We have, at the same time, reversed the Panel's conclusion under Article 5.5 of the SPS Agreement that the levels of protection set by the European Communities in respect of the use of hormones for growth promotion result in discrimination or a disguised restriction on international trade. However, it cannot be assumed that all the findings of fact necessary to proceed to a determination of consistency or inconsistency of the EC measures with the requirements of Article 5.6 have been made by the Panel,

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<sup>260</sup>US Panel Report, para 8.247; Canada Panel Report, para. 8.250.

<sup>261</sup>United States' appellant's submission, para. 4.

<sup>262</sup>United States' appellant's submission, para. 18.

<sup>263</sup>United States' appellant's submission, para. 20.

<sup>264</sup>Canada's appellant's submission, paras. 19-22.

which Article also provides that "technical and economic feasibility" should be taken into account. There appears all the more reason for refraining from an examination of the legality of the measures under Article 5.6 and for adhering to the prudential dictates of the principle of judicial economy.

252. We consider, therefore, and so hold, that the Panel did not err in refraining from making findings on Articles 2.2 and 5.6 of the SPS Agreement.

#### XIV. Findings and Conclusions

253. For the reasons set out in the preceding sections of this Report, the Appellate Body:

- (a) reverses the Panel's general interpretative ruling that the SPS Agreement allocates the evidentiary burden to the Member imposing an SPS measure, and also reverses the Panel's conclusion that when a Member's measure is not based on an international standard in accordance with Article 3.1, the burden is on that Member to show that its SPS measure is consistent with Article 3.3 of the SPS Agreement;
- (b) concludes that the Panel applied the appropriate standard of review under the SPS Agreement;
- (c) upholds the Panel's conclusions that the precautionary principle would not override the explicit wording of Articles 5.1 and 5.2, and that the precautionary principle has been incorporated in, *inter alia*, Article 5.7 of the SPS Agreement;
- (d) upholds the Panel's conclusion that the SPS Agreement, and in particular Articles 5.1 and 5.5 thereof, applies to measures that were enacted before the entry into force of the WTO Agreement, but that remain in force thereafter;
- (e) concludes that the Panel, although it sometimes misinterpreted some of the evidence before it, complied with its obligation under Article 11 of the DSU to make an objective assessment of the facts of the case;

- (f) concludes that the procedures followed by the Panel in both proceedings -- in the selection and use of experts, in granting additional third party rights to the United States and Canada and in making findings based on arguments not made by the parties -- are consistent with the DSU and the SPS Agreement;
- (g) reverses the Panel's conclusion that the term "based on" as used in Articles 3.1 and 3.3 has the same meaning as the term "conform to" as used in Article 3.2 of the SPS Agreement;
- (h) modifies the Panel's interpretation of the relationship between Articles 3.1, 3.2 and 3.3 of the SPS Agreement, and reverses the Panel's conclusion that the European Communities by maintaining, without justification under Article 3.3, SPS measures which are not based on existing international standards, acted inconsistently with Article 3.1 of the SPS Agreement;
- (i) upholds the Panel's finding that a measure, to be consistent with the requirements of Article 3.3, must comply with, *inter alia*, the requirements contained in Article 5 of the SPS Agreement;
- (j) modifies the Panel's interpretation of the concept of "risk assessment" by holding that neither Articles 5.1 and 5.2 nor Annex A.4 of the SPS Agreement require a risk assessment to establish a minimum quantifiable magnitude of risk, nor do these provisions exclude *a priori*, from the scope of a risk assessment, factors which are not susceptible of quantitative analysis by the empirical or experimental laboratory methods commonly associated with the physical sciences;
- (k) reverses the Panel's finding that the term "based on" as used in Article 5.1 of the SPS Agreement entails a "minimum procedural requirement" that a Member imposing an SPS measure must submit evidence that it actually took into account a risk assessment when it enacted or maintained the measure;
- (l) upholds the Panel's finding that the EC measures at issue are inconsistent with the requirements of Article 5.1 of the SPS Agreement, but modifies the Panel's interpretation

- by holding that Article 5.1, read in conjunction with Article 2.2, requires that the results of the risk assessment must sufficiently warrant the SPS measure at stake;
- (m) reverses the Panel's findings and conclusions on Article 5.5 of the SPS Agreement; and
- (n) concludes that the Panel exercised appropriate judicial economy in not making findings on Articles 2.2 and 5.6 of the SPS Agreement.
254. The foregoing legal findings and conclusions uphold, modify and reverse the findings and conclusions of the Panel in Parts VIII and IX of the Panel Reports, but leave intact the findings and conclusions of the Panel that were not the subject of this appeal.
255. The Appellate Body recommends that the Dispute Settlement Body request the European Communities to bring the SPS measures found in this Report and in the Panel Reports, as modified by this Report, to be inconsistent with the SPS Agreement into conformity with the obligations of the European Communities under that Agreement.

Signed in the original at Geneva this 5th day of January 1998 by:

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Florentino Feliciano  
Presiding Member

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Claus-Dieter Ehlermann  
Member

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Mitsuo Matsushita  
Member

**World Trade Organization**

**United States – Import Prohibition of Certain Shrimp and  
Shrimp Products**

**Report of the Appellate Body, 12 October 1998**

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**UNITED STATES – IMPORT PROHIBITION OF  
CERTAIN SHRIMP AND SHRIMP PRODUCTS**

AB-1998-4

*Report of the Appellate Body*

WORLD TRADE ORGANIZATION  
APPELLATE BODY

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**United States – Import Prohibition of Certain Shrimp and Shrimp Products**

AB-1998-4

Present:

United States, *Appellant*  
India, Malaysia, Pakistan, Thailand, *Appellees*

Australia, Ecuador, the European Communities, Hong Kong, China, Mexico and Nigeria, *Third Participants*

Feliciano, Presiding Member  
Bacchus, Member  
Lacarte-Muró, Member

**I. Introduction : Statement of the Appeal**

1. This is an appeal by the United States from certain issues of law and legal interpretations in the Panel Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*.<sup>1</sup> Following a joint request for consultations by India, Malaysia, Pakistan and Thailand on 8 October 1996<sup>2</sup>, Malaysia and Thailand requested in a communication dated 9 January 1997<sup>3</sup>, and Pakistan asked in a communication dated 30 January 1997<sup>4</sup>, that the Dispute Settlement Body (the "DSB") establish a panel to examine their complaint regarding a prohibition imposed by the United States on the importation of certain shrimp and shrimp products by Section 609 of Public Law 101-162<sup>5</sup> ("Section 609") and associated regulations and judicial rulings. On 25 February 1997, the DSB established two panels in accordance with these requests and agreed that these panels would be consolidated into a single Panel, pursuant to Article 9 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), with standard terms of reference.<sup>6</sup> On

<sup>1</sup>WT/DS58/R, 15 May 1998.

<sup>2</sup>WT/DS58/1, 14 October 1996.

<sup>3</sup>WT/DS58/6, 10 January 1997.

<sup>4</sup>WT/DS58/7, 7 February 1997.

<sup>5</sup>16 United States Code (U.S.C.) §1537.

<sup>6</sup>WT/DSB/M/29, 26 March 1997.

10 April 1997, the DSB established another panel with standard terms of reference in accordance with a request made by India in a communication dated 25 February 1997<sup>7</sup>, and agreed that this third panel, too, would be merged into the earlier Panel established on 25 February 1997.<sup>8</sup> The Report rendered by the consolidated Panel was circulated to the Members of the World Trade Organization (the "WTO") on 15 May 1998.

2. The relevant factual and regulatory aspects of this dispute are set out in the Panel Report, in particular at paragraphs 2.1-2.16. Here, we outline the United States measure at stake before the Panel and in these appellate proceedings. The United States issued regulations in 1987 pursuant to the Endangered Species Act of 1973<sup>9</sup> requiring all United States shrimp trawl vessels to use approved Turtle Excluder Devices ("TEDS") or tow-time restrictions in specified areas where there was a significant mortality of sea turtles in shrimp harvesting.<sup>10</sup> These regulations, which became fully effective in 1990, were modified so as to require the use of approved TEDs at all times and in all areas where there is a likelihood that shrimp trawling will interact with sea turtles, with certain limited exceptions.

3. Section 609 was enacted on 21 November 1989. Section 609(a) calls upon the United States Secretary of State, in consultation with the Secretary of Commerce, *inter alia*, to "initiate negotiations as soon as possible for the development of bilateral or multilateral agreements with other nations for the protection and conservation of ... sea turtles" and to "initiate negotiations as soon as possible with all foreign governments which are engaged in, or which have persons or companies engaged in, commercial fishing operations which, as determined by the Secretary of Commerce, may affect adversely such species of sea turtles, for the purpose of entering into bilateral and multilateral treaties with such countries to protect such species of sea turtles; ...". Section 609(b)(1) imposed, not later than 1 May 1991, an import ban on shrimp harvested with commercial fishing technology which may adversely affect sea turtles. Section 609(b)(2) provides that the import ban on shrimp will not apply to harvesting nations that are certified. Two kinds of annual certifications are required for harvesting nations, details of which were further elaborated in regulatory guidelines in 1991, 1993

<sup>7</sup>WT/DS58/8, 4 March 1997.

<sup>8</sup>WT/DSB/M/31, 12 May 1997.

<sup>9</sup>Public Law 93-205, 16 U.S.C. 1531 *et. seq.*

<sup>10</sup>52 Fed. Reg. 24244, 29 June 1987 (the "1987 Regulations"). Five species of sea turtles fell under the regulations: loggerhead (*Caretta caretta*), Kemp's ridley (*Lepidochelys kempi*), green (*Chelonia mydas*), leatherback (*Dermodochelys coriacea*) and hawksbill (*Eretmochelys imbricata*).

and 1996<sup>11</sup>. First, certification shall be granted to countries with a fishing environment which does not pose a threat of the incidental taking of sea turtles in the course of shrimp harvesting.<sup>12</sup> According to the 1996 Guidelines, the Department of State "shall certify any harvesting nation meeting the following criteria without the need for action on the part of the government of the harvesting nation: (a) Any harvesting nation without any of the relevant species of sea turtles occurring in waters subject to its jurisdiction; (b) Any harvesting nation that harvests shrimp exclusively by means that do not pose a threat to sea turtles, e.g., any nation that harvests shrimp exclusively by artisanal means; or (c) Any nation whose commercial shrimp trawling operations take place exclusively in waters subject to its jurisdiction in which sea turtles do not occur."<sup>13</sup>

4. Second, certification shall be granted to harvesting nations that provide documentary evidence of the adoption of a regulatory program governing the incidental taking of sea turtles in the course of shrimp trawling that is comparable to the United States program *and* where the average rate of incidental taking of sea turtles by their vessels is comparable to that of United States vessels.<sup>14</sup> According to the 1996 Guidelines, the Department of State assesses the regulatory program of the harvesting nation and certification shall be made if the program includes: (i) the required use of TEDs that are "comparable in effectiveness to those used in the United States. Any exceptions to this requirement must be comparable to those of the United States program ..."; and (ii) "a credible enforcement effort that includes monitoring for compliance and appropriate sanctions."<sup>15</sup> The regulatory program may be in the form of regulations, or may, in certain circumstances, take the form of a voluntary arrangement between industry and government.<sup>16</sup> Other measures that the harvesting nation undertakes for the protection of sea turtles will also be taken into account in making the comparability determination.<sup>17</sup> The average incidental take rate "will be deemed comparable if the harvesting nation requires the use of TEDs in a manner comparable to that of the U.S. program ...".<sup>18</sup>

5. The 1996 Guidelines provide that all shrimp imported into the United States must be accompanied by a Shrimp Exporter's Declaration form attesting that the shrimp was harvested either

<sup>11</sup>Hereinafter referred to as the "1991 Guidelines" (56 Federal Register 1051, 10 January 1991), the "1993 Guidelines" (58 Federal Register 9015, 18 February 1993) and the "1996 Guidelines" (61 Federal Register 17342, 19 April 1996), respectively.

<sup>12</sup>Section 609(b)(2)(C).

<sup>13</sup>1996 Guidelines, p. 17343.

<sup>14</sup>Section 609(b)(2)(A) and (B).

<sup>15</sup>1996 Guidelines, p. 17344.

<sup>16</sup>*Ibid.*

<sup>17</sup>*Ibid.*

<sup>18</sup>*Ibid.*

in the waters of a nation currently certified under Section 609 or "under conditions that do not adversely affect sea turtles", that is: (a) "Shrimp harvested in an aquaculture facility in which the shrimp spend at least 30 days in ponds prior to being harvested"; (b) "Shrimp harvested by commercial shrimp trawl vessels using TEDs comparable in effectiveness to those required in the United States"; (c) "Shrimp harvested exclusively by means that do not involve the retrieval of fishing nets by mechanical devices or by vessels using gear that, in accordance with the U.S. program . . . , would not require TEDs"; and (d) "Species of shrimp, such as the pandalid species, harvested in areas where sea turtles do not occur."<sup>19</sup> On 8 October 1996, the United States Court of International Trade ruled that the 1996 Guidelines were in violation of Section 609 in allowing the import of shrimp from non-certified countries if accompanied by a Shrimp Exporter's Declaration form attesting that they were caught with commercial fishing technology that did not adversely affect sea turtles.<sup>20</sup> A 25 November 1996 ruling of the United States Court of International Trade clarified that shrimp harvested by manual methods which did not harm sea turtles could still be imported from non-certified countries.<sup>21</sup> On 4 June 1998, the United States Court of Appeals for the Federal Circuit vacated the decisions of the United States Court of International Trade of 8 October and 25 November 1996.<sup>22</sup> In practice, however, exemption from the import ban for TED-caught shrimp from non-certified countries remained unavailable while this dispute was before the Panel and before us.<sup>23</sup>

6. The 1991 Guidelines limited the geographical scope of the import ban imposed by Section 609 to countries in the wider Caribbean/western Atlantic region<sup>24</sup>, and granted these countries a three-year phase-in period. The 1993 Guidelines maintained this geographical limitation. On 29 December 1995, the United States Court of International Trade held that the 1991 and 1993 Guidelines violated Section 609 by limiting its geographical scope to shrimp harvested in the wider Caribbean/western Atlantic region, and directed the Department of State to extend the ban worldwide not later than 1 May 1996.<sup>25</sup> On 10 April 1996, the United States Court of International Trade refused a subsequent request by the Department of State to postpone the 1 May 1996 deadline.<sup>26</sup> On

<sup>19</sup>1996 Guidelines, p. 17343.

<sup>20</sup>*Earth Island Institute v. Warren Christopher*, 942 Fed. Supp. 597 (CIT 1996).

<sup>21</sup>*Earth Island Institute v. Warren Christopher*, 948 Fed. Supp. 1062 (CIT 1996).

<sup>22</sup>1998 U.S. App. Lexis 11789.

<sup>23</sup>Response by the United States to questioning at the oral hearing.

<sup>24</sup>Specifically, Mexico, Belize, Guatemala, Honduras, Nicaragua, Costa Rica, Panama, Colombia, Venezuela, Trinidad and Tobago, Guyana, Suriname, French Guyana and Brazil.

<sup>25</sup>*Earth Island Institute v. Warren Christopher*, 913 Fed. Supp. 559 (CIT 1995).

<sup>26</sup>*Earth Island Institute v. Warren Christopher*, 922 Fed. Supp. 616 (CIT 1996).

19 April 1996, the United States issued the 1996 Guidelines, extending Section 609 to shrimp harvested in *all* foreign countries effective 1 May 1996.

7. In the Panel Report, the Panel reached the following conclusions:

In the light of the findings above, we conclude that the import ban on shrimp and shrimp products as applied by the United States on the basis of Section 609 of Public Law 101-162 is not consistent with Article XI:1 of GATT 1994, and cannot be justified under Article XX of GATT 1994.<sup>27</sup>

and made this recommendation:

The Panel *recommends* that the Dispute Settlement Body request the United States to bring this measure into conformity with its obligations under the WTO Agreement.<sup>28</sup>

8. On 13 July 1998, the United States notified the DSB of its decision to appeal certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel, pursuant to paragraph 4 of Article 16 of the DSU, and filed a notice of appeal<sup>29</sup> with the Appellate Body pursuant to Rule 20 of the *Working Procedures for Appellate Review*. On 23 July 1998, the United States filed an appellant's submission.<sup>30</sup> On 7 August 1998, India, Pakistan and Thailand ("Joint Appellees") filed a joint appellees' submission and Malaysia filed a separate appellee's submission.<sup>31</sup> On the same day, Australia, Ecuador, the European Communities, Hong Kong, China, and Nigeria each filed separate third participants' submissions.<sup>32</sup> At the invitation of the Appellate Body, the United States, India, Pakistan, Thailand and Malaysia filed additional submissions on certain issues arising under Article XX(b) and Article XX(g) of the GATT 1994 on 17 August 1998. The oral hearing in the appeal was held on 19-20 August 1998. The participants and third participants presented oral arguments and responded to questions put to them by the Members of the Division hearing the appeal.

<sup>27</sup>Panel Report, para. 8.1.

<sup>28</sup>Panel Report, para. 8.2.

<sup>29</sup>WT/DS58/11, 13 July 1998.

<sup>30</sup>Pursuant to Rule 21(1) of the *Working Procedures for Appellate Review*.

<sup>31</sup>Pursuant to Rule 22(1) of the *Working Procedures for Appellate Review*.

<sup>32</sup>Pursuant to Rule 24 of the *Working Procedures for Appellate Review*.

## II. Arguments of the Participants and Third Participants

### A. *Claims of Error by the United States – Appellant*

1. Non-requested Information from Non-governmental Organizations

9. The United States claims that the Panel erred in finding that it could not accept non-requested submissions from non-governmental organizations. According to the United States, there is nothing in the DSU that prohibits panels from considering information just because the information was unsolicited. The language of Article 13.2 of the DSU is broadly drafted to provide a panel with discretion in choosing its sources of information. When a non-governmental organization makes a submission to a panel, Article 13.2 of the DSU authorizes the panel to "seek" such information. To find otherwise would unnecessarily limit the discretion that the DSU affords panels in choosing the sources of information to consider.

### 2. Article XX of the GATT 1994

10. In the view of the United States, the Panel erred in finding that Section 609 was outside the scope of Article XX. The United States stresses that under the Panel's factual findings and undisputed facts on the record, Section 609 is within the scope of the Article XX chapeau and Article XX(g) and, in the alternative, Article XX(b), of the GATT 1994. The Panel was also incorrect in finding that Section 609 constitutes "unjustifiable discrimination between countries where the same conditions prevail". The Panel interprets the chapeau of Article XX as requiring panels to determine whether a measure constitutes a "threat to the multilateral trading system". This interpretation of Article XX has no basis in the text of the GATT 1994, has never been adopted by any previous panel or Appellate Body Report, and would impermissibly diminish the rights that WTO Members reserved under Article XX.

11. The United States contends that the Panel's findings are not based on the ordinary meaning and context of the term "unjustifiable discrimination". That term raises the issue of whether a particular discrimination is "justifiable". During the Panel proceeding, the United States presented the rationale of Section 609 for restricting imports of shrimp from some countries and not from others: sea turtles are threatened with extinction worldwide; most nations, including the appellees, recognize the importance of conserving sea turtles; and shrimp trawling without the use of TEDs contributes greatly to the endangerment of sea turtles. In these circumstances, it is reasonable and justifiable for Section 609 to differentiate between countries whose shrimp industries operate without TEDs, and

thereby endanger sea turtles, and those countries whose shrimp industries do employ TEDs in the course of harvesting shrimp.

12. The Panel, the United States believes, did not address the rationale of the United States for differentiating between shrimp harvesting countries. Rather, the Panel asked a different question: would the United States measure and similar measures taken by other countries "undermine the multilateral trading system"? The distinction between "unjustifiable discrimination" -- the actual term used in the GATT 1994 -- and the Panel's "threat to the multilateral trading system" test is crucial, in the view of the United States, and is posed sharply in paragraph 7.61 of the Panel Report, where the Panel states: "even though the situation of turtles is a serious one, we consider that the United States adopted measures which, irrespective of their environmental purpose, were clearly a threat to the multilateral trading system ...". An environmental purpose is fundamental to the application of Article XX, and such a purpose cannot be ignored, especially since the preamble to the *Marrakesh Agreement Establishing the World Trade Organization*<sup>33</sup> (the "*WTO Agreement*") acknowledges that the rules of trade should be "in accordance with the objective of sustainable development", and should seek to "protect and preserve the environment". Moreover, Article XX neither defines nor mentions the "multilateral trading system", nor conditions a Member's right to adopt a trade-restricting measure on the basis of hypothetical effects on that system.

13. In adopting its "threat to the multilateral trading system" analysis, the Panel fails to apply the ordinary meaning of the text: whether a justification can be presented for applying a measure in a manner which constitutes discrimination. Instead, the Panel expands the ordinary meaning of the text to encompass a much broader and more subjective inquiry. As a result, the Panel would add an entirely new obligation under Article XX of the GATT 1994: namely that Members may not adopt measures that would result in certain effects on the trading system. Under the ordinary meaning of the text, there is sufficient justification for an environmental conservation measure if a conservation purpose justifies a difference in treatment between Members. Further inquiry into effects on the trading system is uncalled for and incorrect.

14. In the view of the United States, the Panel also fails to take account of the context of the term "unjustifiable discrimination". The language of the Article XX chapeau indicates that the chapeau was intended to prevent the abusive application of the exceptions for protectionist or other discriminatory aims. This is consistent with the approach of the Appellate Body in *United States – Standards for Reformulated and Conventional Gasoline*<sup>34</sup> ("*United States – Gasoline*") and with the

<sup>33</sup>Done at Marrakesh, 15 April 1994.

<sup>34</sup>Adopted 20 May 1996, WT/DS2/AB/R.

preparatory work of the GATT 1947. In context, an alleged "discrimination between countries where the same conditions prevail" is not "unjustifiable" where the policy goal of the Article XX exception being applied provides a rationale for the justification.

15. In the context of the GATT/WTO dispute settlement system, measures within the scope of Article XX can be expected to result in reduced market access or discriminatory treatment. To interpret the prohibition of "unjustifiable discrimination" in the Article XX chapeau as excluding measures which result in "reduced market access" or "discriminatory treatment" would, in effect, erase Article XX from the GATT 1994. The Panel's "threat to the multilateral trading system" analysis erroneously confuses the question of whether a measure reduces market access with the further and separate question arising under the chapeau as to whether that measure is nevertheless "justifiable" under one of the general exceptions in Article XX. The proper inquiry under the Article XX chapeau is whether a non-protectionist rationale, such as a rationale based on the policy goal of the applicable Article XX exception, could justify any discrimination resulting from the measure. Here, any "discrimination" resulting from the measure is based on, and in support of, the goal of sea turtle conservation.

16. The United States also argues that the Panel incorrectly applies the object and purpose of the *WTO Agreement* in interpreting Article XX of the GATT 1994. It is legal error to jump from the observation that the GATT 1994 is a trade agreement to the conclusion that trade concerns must prevail over all other concerns in all situations arising under GATT rules. The very language of Article XX indicates that the state interests protected in that article are, in a sense, "pre-eminent" to the GATT's goals of promoting market access.

17. Furthermore, the Panel failed to recognize that most treaties have no single, undiluted object and purpose but rather a variety of different, and possibly conflicting, objects and purposes. This is certainly true of the *WTO Agreement*. Thus, while the first clause of the preamble to the *WTO Agreement* calls for the expansion of trade in goods and services, this same clause also recognizes that international trade and economic relations under the *WTO Agreement* should allow for "optimal use of the world's resources in accordance with the objective of sustainable development", and should seek "to protect and preserve the environment". The Panel in effect took a one-sided view of the object and purpose of the *WTO Agreement* when it fashioned a new test not found in the text of the Agreement.

18. The additional bases, the United States continues, invoked by the Panel to support its "threat to the multilateral trading system" analysis -- i.e. the protection of expectations of Members as to the competitive relationship between their products and the products of other Members; the application

of the international law principle according to which international agreements must be applied in good faith; and the *Belgian Family Allowances*<sup>35</sup> panel report -- are without merit.

19. The United States submits that Section 609 does not threaten the multilateral trading system. The Panel did not find Section 609 to be an *actual* threat to the multilateral trading system. Rather, the Panel found that if other countries in other circumstances were to adopt the same type of measure here adopted by the United States *potentially* a threat to the system might arise. The United States urges that in engaging in hypothetical speculations regarding the effects of other measures which might be adopted in differing situations, while ignoring the compelling circumstances of this case, the Panel violated the Appellate Body's prescription in *United States - Gasoline*<sup>36</sup> that Article XX must be applied on a "case-by-case basis", with careful scrutiny of the specific facts of the case at hand. The Panel's "threat to the multilateral trading system" analysis adds a new obligation under Article XX of the GATT 1994 and is inconsistent with the proper role of the Panel under the DSU, in particular Articles 3.2 and 19.2 thereof.

20. To the United States, Section 609 reasonably differentiates between countries on the basis of the risk posed to endangered sea turtles by their shrimp trawling industries. Considering the aim of the Article XX chapeau to prevent abuse of the Article XX exceptions, an evaluation of whether a measure constitutes "unjustifiable discrimination where the same conditions prevail" should take account of whether the differing treatment between countries relates to the policy goal of the applicable Article XX exception. If a measure differentiates between countries on a basis "legitimately connected" with the policy of an Article XX exception, rather than for protectionist reasons, that measure does not amount to an abuse of the applicable Article XX exception.

21. The contention of the United States is that its measure does not treat differently those countries whose shrimp trawling industries pose similar risks to sea turtles. Only nations with shrimp trawling industries that harvest shrimp in waters where there is a likelihood of intercepting sea turtles, and that employ mechanical equipment which harms sea turtles, are subject to the import restrictions. The Panel properly recognized that certain naturally-occurring conditions relating to sea turtle conservation (namely, whether sea turtles and shrimp occur concurrently in a Member's waters) and at least certain conditions relating to how shrimp are caught (namely, whether shrimp nets are retrieved mechanically or by hand) are relevant factors in applying the Article XX chapeau. However, the Panel found that another condition relating to how shrimp are caught -- namely, whether a country requires its shrimp fishermen to use TEDs -- did not provide a basis under the chapeau for

<sup>35</sup> Adopted 7 November 1952, BISD 1S/59.

<sup>36</sup> Adopted 20 May 1996, WT/DS2/AB/R.

treating countries differently. Differing treatment based on whether a country had adopted a TEDs requirement was, in the Panel's view, "unjustifiable".

22. The United States believes that the analysis employed by the Appellate Body in *United States - Gasoline*<sup>37</sup> leads to the conclusion that Section 609 does not constitute "unjustifiable discrimination". Section 609 is applied narrowly and fairly. The United States does not apply sea turtle conservation rules differently to United States and foreign shrimp fishermen. Moreover, the United States has taken steps to assist foreign shrimp fishermen in adopting conservation measures and has undertaken efforts to transfer TED technology to governments and industries in other countries, including the appellees. In addition, Section 609 is limited in coverage and focuses on sea turtle conservation.

23. During the Panel proceeding, the United States presented "compelling evidence", reaffirmed by five independent experts, that Section 609 was a *bona fide* conservation measure under Article XX, imbued with the purpose of conserving a species facing the threat of extinction. To uphold the findings of the Panel would impermissibly change the basic terms of the bargain agreed to by WTO Members in agreeing to the GATT 1994. Further, to condone the Panel's adoption of a vague and subjective "threat to the multilateral trading system" test would fundamentally alter the intended role of panels under the DSU, and could call into question the legitimacy of the WTO dispute settlement process.

24. The United States states that neither it nor the appellees have appealed the decisions of the Panel to address first the Article XX chapeau and not to reach the issues regarding Article XX(b) and Article XX(g). Because the Panel made no findings regarding the applicability of Article XX(b) and XX(g), there are no findings in respect thereof that could even be the subject of appeal. Accordingly, issues regarding the applicability of Article XX(b) and Article XX(g) are not initially presented to the Appellate Body. However, the United States concurs with Joint Appellees that the Appellate Body may address Article XX(b) or Article XX(g) if it finds that Section 609 meets the criteria of the Article XX chapeau. In that case, the United States asserts that Article XX(g) should be applied first as it is the "most pertinent" of the Article XX exceptions, and that issues relating to Article XX(b) need be reached only if Article XX(g) were found to be inapplicable. The United States incorporates by reference and briefly summarizes the submissions that it made to the Panel regarding Article XX(b) and Article XX(g).

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<sup>37</sup>Adopted 20 May 1996, WT/DS2/AB/R.

25. The essential claim of the United States is that Section 609 meets each element required under Article XX(g). Sea turtles are important natural resources. They are also an exhaustible natural resource since all species of sea turtles, including those found in the appellees' waters, face the danger of extinction. All species of sea turtles have been included in Appendix I of the Convention on International Trade in Endangered Species of Wild Flora and Fauna<sup>38</sup> (the "CITES") since 1975, and other international agreements also recognize the endangered status of sea turtles.<sup>39</sup> In paragraph 7.58 of the Panel Report, the Panel noted: "The endangered nature of the species of sea turtles mentioned in [CITES] Annex I as well as the need to protect them are consequently not contested by the parties to the dispute."

26. The United States maintains Section 609 "relates to" the conservation of sea turtles. A "substantial relationship" exists between Section 609 and the conservation of sea turtles. Shrimp trawl nets are a major cause of human-induced sea turtle deaths, and TEDs are highly effective in preventing such mortality. The Panel noted that "TEDs, when properly installed and used and adapted to the local area, would be an effective tool for the preservation of sea turtles."<sup>40</sup> By encouraging the use of TEDs, Section 609 promotes sea turtle conservation.

27. The United States contends that Section 609 is also "made effective in conjunction with restrictions on domestic production or consumption" within the meaning of Article XX(g). The United States requires its shrimp trawl vessels that operate in waters where there is a likelihood of intercepting sea turtles to use TEDs at all times, and Section 609 applies comparable standards to imported shrimp. Section 609 is also "even-handed": it allows any nation to be certified -- and thus avoid any restriction on shrimp exports to the United States -- if it meets criteria for sea turtle conservation in the course of shrimp harvesting that are comparable to criteria applicable in the United States. With respect to nations whose shrimp trawl vessels operate in waters where there is a likelihood of intercepting sea turtles, Section 609 provides for certification where those nations adopt TEDs-use requirements comparable to those in effect in the United States.

28. The United States submits, moreover, that Section 609 is a measure "necessary to protect human, animal or plant life or health" within the meaning of Article XX(b). Section 609 is intended

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<sup>38</sup>Done at Washington, 3 March 1973, 993 U.N.T.S. 243, 12 International Legal Materials 1085.

<sup>39</sup>The United States states that all species of sea turtle except the flatback are listed in Appendices I and II of the Convention on the Conservation of Migratory Species of Wild Animals, done at Bonn, 23 June 1979, 19 International Legal Materials 15; and in Appendix II of the Protocol concerning Specially Protected Areas and Wildlife to the Convention for the Protection and Development of the Marine Environment of the Wider Caribbean Region, 29 March 1983, T.I.A.S. No. 11085.

<sup>40</sup>The United States refers to Panel Report, para. 7.60, footnote 674.

to protect and conserve the life and health of sea turtles, by requiring that shrimp imported into the United States shall not have been harvested in a manner harmful to sea turtles. Section 609 is "necessary" in two different senses. First, efforts to reduce sea turtle mortality are "necessary" because all species of sea turtles are threatened with extinction. Second, Section 609 relating to the use of TEDs is "necessary" because other measures to protect sea turtles are not sufficient to allow sea turtles to move back from the brink of extinction.

B. *India, Pakistan and Thailand – Joint Appellees*

1. Non-requested Information from Non-governmental Organizations

29. Joint Appellees submit that the Panel's ruling rejecting non-requested information is correct and should be upheld. According to Joint Appellees, the United States misinterprets Article 13 of the DSU in arguing that nothing in the DSU prohibits panels from considering information merely because the information was unsolicited. The Panel correctly noted that, "pursuant to Article 13 of the DSU, the initiative to seek information and to select the source of information rests with the Panel."<sup>41</sup> It is evident from Article 13 that Members have chosen to establish a formalized system for the collection of information, which gives a panel discretion to determine the information it needs to resolve a dispute. Panels have no obligation to consider unsolicited information, and the United States is wrong to argue that they do.

30. According to Joint Appellees, when a panel does seek information from an individual or body within a Member's jurisdiction, that panel has an obligation to inform the authorities of that Member. This demonstrates that a panel retains control over the information sought, and also that the panel is required to keep the Members informed of its activities. The process accepted by the Members necessarily implies three steps: a panel's decision to seek technical advice; the notification to a Member that such advice is being sought within its jurisdiction; and the consideration of the requested advice. In the view of Joint Appellees, the interpretation offered by the United States would eliminate the first two of these three steps, thereby depriving a panel of its right to decide whether it needs supplemental information, and what type of information it should seek; as well as depriving Members of their right to know that information is being sought from within their jurisdiction.

31. Joint Appellees point to Appendix 3 of the DSU, which sets out Working Procedures for panels, and especially paragraphs 4 and 6 thereof, which limit the right to present panels with written submissions to parties and third parties. Thus, Joint Appellees argue, Members that are not parties or third parties cannot avail themselves of the right to present written submissions. It would be unreasonable, in the view of Joint Appellees, to interpret the DSU as granting the right to submit an unsolicited written submission to a non-Member, when many Members do not enjoy a similar right.

32. Joint Appellees maintain that, if carried to its logical conclusion, the appellant's argument could result in panels being deluged with unsolicited information from around the world. Such information might be strongly biased, if nationals from Members involved in a dispute could provide unsolicited information. They argue that this would not improve the dispute settlement mechanism, and would only increase the administrative tasks of the already overburdened Secretariat.

33. Joint Appellees argue as well that parties to a panel proceeding might feel obliged to respond to all unsolicited submissions -- just in case one of the unsolicited submissions catches the attention of a panel member. Due process requires that a party know what submissions a panel intends to consider, and that all parties be given an opportunity to respond to all submissions. Finally, because Article 12.6 of the DSU requires that second written submissions of the parties be submitted simultaneously, if a party is permitted to append *amicus curiae* briefs to its second submission, other parties can be deprived of their right to respond and be heard.

2. Article XX of the GATT 1994

34. Joint Appellees maintain that the Panel's ruling on the chapeau of Article XX is correct and should be upheld by the Appellate Body. They underline that the appellant does not appeal either the Panel's conclusion that Section 609 violated Article XI:1 of the GATT 1994, or the Panel's decision to address the chapeau of Article XX before addressing sub-paragraph (b) or (g) of that Article. Nor does the United States dispute that it bears the burden of proving that its measure is within Article XX. The United States takes issue with the Panel's alleged application of the chapeau to protect against a "threat to the multilateral trading system", submitting that the Panel developed a new chapeau "interpretation", "analysis" or "test" to invalidate Section 609, thus impermissibly diminishing the rights of WTO Members. According to Joint Appellees, the appellant's argument is baseless and results from a mischaracterization of the Panel's decision. The Panel did not invent a new "interpretation", "analysis" or "test", nor did it simply interpret "unjustifiable" to mean "a threat to the multilateral trading system". Instead, the Panel rendered a well-reasoned decision fully

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<sup>41</sup>Joint Appellees refer to Panel Report, para. 7.8.

supported by the *WTO Agreement*, past GATT/WTO practice, and the accepted rules of interpretation set forth in the Vienna Convention on the Law of Treaties<sup>42</sup> (the "Vienna Convention").

35. Joint Appellees argue that the flaw in Section 609, and in the appellant's argument, is the appellant's failure to accept that conditioning access to markets for a given product upon the adoption of certain policies by exporting Members, can violate the *WTO Agreement*. A Member must seek multilateral solutions to trade-related environmental problems. The threat to the multilateral trade system cited by the Panel is unrelated to the appellant's support for TEDs or turtle conservation. The threat is much simpler: the United States has abused Article XX by unilaterally developing a trade policy, and unilaterally imposing this policy through a trade embargo, as opposed to proceeding down the multilateral path. The multilateral trade system is based on multilateral cooperation. If every WTO Member were free to pursue its own trade policy solutions to what it perceives to be environmental concerns, the multilateral trade system would cease to exist. By preventing the abuse of Article XX, the chapeau protects against threats to the multilateral trading system. The prevention of abuse and the prevention of threats to the multilateral trading system are therefore inextricably linked to the object, purpose and goals of Article XX of the GATT 1994.

36. Joint Appellees submit that on the basis of its interpretation of the term "unjustifiable" in the chapeau and in light of the object and purpose of Article XX of the GATT 1994 and the object and purpose of the *WTO Agreement*, the Panel concluded that the chapeau of Article XX permits Members to derogate from GATT provisions, but prohibits derogations which would constitute abuse of the exceptions contained in Article XX, thereby undermining the WTO multilateral trading system. According to Joint Appellees, what the appellant claims to be a new "test" for justifiability is nothing more than a restatement of the principle that the chapeau's object and purpose is to prevent the abuse of the Article XX exceptions, specifying more clearly what may result from such abuse. In the light of recent and past GATT/WTO practice, in particular the panel report in *United States – Restrictions on Imports of Tuna*<sup>43</sup>, the Panel correctly interpreted the chapeau, identifying its object and purpose as the prevention of abuse of the Article XX exceptions, and associating the prevention of such abuse with the preservation of the multilateral trading system.

<sup>42</sup>Done at Vienna, 23 May 1969, 1155 U.N.T.S. 33; 8 International Legal Materials 679.

<sup>43</sup>Unadopted, DS29/R, 16 June 1994, para 5.26.

37. In the view of Joint Appellees, the Panel's decision mirrors the Appellate Body's reasoning in *United States – Gasoline*<sup>44</sup> and is therefore correct. The Appellate Body made three pronouncements in *United States – Gasoline* that influenced the Panel's ruling: first, that the chapeau, by its express terms, addresses, not so much the questioned measure or its specific contents as such, but rather the manner in which the measure is applied<sup>45</sup>; second, that it is, accordingly, important to underscore that the purpose and object of the introductory clauses of Article XX is generally the prevention of abuse of the exceptions of Article XX<sup>46</sup>; and, third, that the Appellate Body cautioned against the application of Article XX exceptions so as to "frustrate or defeat" legal obligations of the holder of rights under the GATT 1994.<sup>47</sup>

38. Joint Appellees state that, in examining Section 609, the Panel paid particular attention to the manner in which the embargo is applied, and the Panel noted that the appellant conditioned market access on the adoption by exporting Members of conservation policies comparable to its own. The Panel also found that the United States did not enter into negotiations before it imposed its import ban. The Panel concluded that Section 609 abused Article XX and posed a threat to the multilateral trading system. The Panel equated the prevention of the abuse of Article XX with the avoidance of measures that would "frustrate or defeat the purposes and objects of the General Agreement and the WTO Agreement or its legal obligations under the substantive rules of GATT by abusing the exception contained in Article XX."<sup>48</sup> The Panel buttressed its conclusion by referring to the related principles of good faith and *pacta sunt servanda*, and by citing the *Belgian Family Allowances*<sup>49</sup> panel report.

39. Should the Appellate Body decide to reverse the Panel's findings with respect to the chapeau of Article XX, Joint Appellees request that the Appellate Body rule that Section 609 is "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" in violation of the chapeau of Article XX. Consistently with its decision in *United States – Gasoline*<sup>50</sup>, the Appellate Body should examine the manner in which Section 609 has been applied, and decide whether an

<sup>44</sup>Adopted 20 May 1996, WT/DS2/AB/R.

<sup>45</sup>*United States – Gasoline*, adopted 20 May 1996, WT/DS2/AB/R, page 22.

<sup>46</sup>*Ibid.*

<sup>47</sup>*Ibid.*

<sup>48</sup>Joint Appellees refer to Panel Report, para 7.40.

<sup>49</sup>Adopted 7 November 1952, BISD 1S/59.

<sup>50</sup>Adopted 20 May 1996, WT/DS2/AB/R.

Article XX exception is being abused so as to frustrate or defeat the substantive rights of the appellees under the GATT 1994.

40. Joint Appellees submit that, even leaving aside the "threat to the multilateral trading system" language of the Panel, there is "compelling evidence" in the record that the appellant abused Article XX and its exceptions. Joint Appellees maintain that this abuse takes several forms, each instance "grave", and, by itself, adequate to support a finding that Section 609 has been applied in an abusive manner so as to frustrate the substantive rights of the appellees under the *WTO Agreement*.

41. First, Section 609 was applied without a serious attempt to reach a cooperative multilateral solution with Joint Appellees. The importance of multilateralism should be clear to the United States because it is an integral provision of Section 609, has been emphasised at numerous GATT and WTO meetings, is reflected in Article 23.1 of the DSU and in Principle 12 of the Rio Declaration on Environment and Development<sup>51</sup>, and was underscored by the Appellate Body in *United States - Gasoline*.<sup>52</sup> The chapeau violation that the United States committed in *United States - Gasoline* is, Joint Appellees believe, the same violation committed by the United States in this dispute.

42. Second, the United States discriminated impermissibly among exporting countries, and between exporting countries and the United States in, *inter alia*, the following ways: (a) "[t]he Panel found that the Appellant negotiated an agreement to protect and conserve sea turtles with some WTO Members, but did not propose the negotiation of such an agreement with the ... Appellees until after having concluded its negotiations with the other Members. The Panel also found that Section 609 was already in effect against the Appellees by the time such negotiations were proposed"; (b) "[p]hase-in periods for the use of TEDs differed depending on the countries involved. 'Initially affected countries' had a three year phase-in period, while 'newly affected nations' were given four months or less to change shrimp harvesting practices"; and (c) Section 609 "discriminates between products based on non-product-related processes and production methods."

43. Third, Joint Appellees contend that the appellant's argument misconstrues key portions of the chapeau and of the Panel Report. The appellant's starting-point is that the Panel's findings are not based on the ordinary meaning of the phrase "unjustifiable discrimination" in the context in which it appears. The appellant also suggests that the only object and purpose of the chapeau is the prevention of "indirect protection". This interpretation is contradicted by recent WTO practice. The Appellate

Body Report in *United States - Gasoline*<sup>53</sup> stands for the proposition that "unjustifiable discrimination" has a meaning larger than "indirect protection". The appellant, in effect, suggests that justifiability should be determined by reference to the specific Article XX exception invoked. If discrimination were to be justified merely on the basis of the policy goals of the particular exception invoked, all trade measures that meet the requirements of an Article XX exception would, *ipso facto*, satisfy the requirements of the chapeau. The chapeau would be rendered meaningless -- in violation of the commonly accepted rule of treaty interpretation which requires that meaning and effect be given to all treaty terms. The principles enunciated in the Appellate Body Report in *United States - Gasoline* would also become null.

44. Joint Appellees argue that both the Appellate Body in *United States - Gasoline*<sup>54</sup> and the Panel in the present case, recognized that the Article XX chapeau must be interpreted in light of the object and purpose of the *WTO Agreement*. This does not mean re-incorporating substantive GATT provisions into the analysis through the chapeau; it means instead examining a proposed Article XX derogation from the perspective of the broader policy goals of the *WTO Agreement*. The Panel identified two such goals: endeavouring to find cooperative solutions to trade problems; and preventing the risk that a multiplicity of conflicting trade requirements, each justified by reference to Article XX, could emerge. Section 609 jeopardizes both goals and poses a threat to the multilateral trading system.

45. Should the Appellate Body decide to reverse the Panel's legal findings with respect to the chapeau of Article XX and rule that Section 609 meets the requirements of the chapeau, Joint Appellees request that the Appellate Body make legal findings on Article XX(b) and Article XX(g) of the GATT 1994. They incorporate by reference their submissions to the Panel with respect to the interpretation of Article XX(b) and Article XX(g), while noting at the same time that there are persuasive reasons for following the interpretative approach adopted by the Panel in examining the chapeau first. Not only does the concept of judicial economy favour such an analysis, but also none of the participants has questioned the Panel's interpretative approach in their submissions (although, Joint Appellees note, one third participant, Australia, did comment with disapproval on this approach).

<sup>51</sup>UN Doc. A/CONF. 151/5/Rev.1, 13 June 1992, 31 International Legal Materials 874.

<sup>52</sup>Adopted 20 May 1996, WT/DS2/AB/R, pp. 27-28.

<sup>53</sup>Adopted 20 May 1996, WT/DS2/AB/R.

<sup>54</sup>*Ibid.*

C. *Malaysia - Appellee*

1. Non-requested Information from Non-governmental Organizations

46. Malaysia submits that the Panel ruled correctly on this issue and that its ruling should be upheld as there is nothing in the DSU that *permits* the admission of unsolicited briefs from non-governmental organizations. Malaysia does not agree with the United States that there is nothing in the DSU *prohibiting* panels from considering information just because the information was offered unsolicited. Under Article 13 of the DSU, the prerequisite for invocation of that provision is that a panel must "seek" information. In the view of Malaysia, the Panel correctly noted that the initiative to seek information and to select the source of information rests with the Panel. The Panel could not consider unsolicited information. In the alternative, should the Appellate Body accept the United States argument that panels may accept *amicus curia* briefs, it must be left to the complete discretion of panel members whether or not to read them. A panel's decision not to read the briefs cannot constitute a procedural mistake and cannot influence the outcome of a panel report.

2. Article XX of the GATT 1994

47. Malaysia maintains that the Panel's decision concerning Article XX of the GATT 1994 represents a balanced view of the requirements of the *WTO Agreement*, rules of treaty interpretation and GATT practice. The appellant misconceives the Panel's findings: the Panel did not in any way allude to the supremacy of trade concerns over non-trade concerns, and did not fail to recognize that most treaties have no single, undiluted object and purpose but a variety of different objects and purposes. The Panel in fact alluded to the first, second and third paragraphs of the preamble to the *WTO Agreement*, which make reference to different objects and purposes. Moreover, in Malaysia's view, the appellant misapplies the principle in *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products*<sup>55</sup> to the facts of this case, and misconstrues the Panel's application of the *Belgian Family Allowances*<sup>56</sup> panel report.

48. To Malaysia, the Panel's "threat to the multilateral trading system" analysis does not constitute a new test, but is in fact a restatement of the approach taken by the Panel that Members are not allowed to resort to measures that would undermine the multilateral trading system and thus abuse the exceptions contained in Article XX. The Panel itself states that its findings are the result of the

application of the interpretative methods required by Article 3.2 of the DSU and that its process of interpretation does not add to Members' obligations in contravention of Article 3.2 of the DSU.

49. It was also noted by Malaysia that the Panel found on the facts that the import ban is applied even on TED-caught shrimp, as long as the country has not been certified; certification is only granted if comprehensive requirements regarding the use of TEDs by fishing vessels are applied by the exporting country concerned or if shrimp trawling operations of the exporting country take place exclusively in waters in which sea turtles do not occur. On the basis of these findings, the Panel concluded that the United States measure constitutes unjustifiable discrimination between countries where the same conditions prevail.

50. Malaysia believes that the Panel relied in large measure on the Appellate Body Report in *United States - Gasoline*.<sup>57</sup> Although the requirement of use of TEDs is applied to both United States and foreign shrimp trawlers, Malaysia contends that Section 609 violates the chapeau prohibition of "unjustifiable discrimination between countries where the same conditions prevail": not all species of sea turtles covered by Section 609 and found in Malaysia and the United States are alike -- Kemp's ridley and loggerhead turtles, which occur in the United States, are absent or occur only in negligible numbers in Malaysian waters; the habitats of these turtles do not coincide with areas of shrimp trawling operations in Malaysia; certain countries which have been exempted from TED requirements are harvesting sea turtles commercially and exploiting the eggs; and the time given to countries to comply with the requirements of Section 609 varied.

51. In response to the appellant's statement that it has taken steps to assist foreign shrimp fishermen in adopting turtle conservation measures, Malaysia states that there has been no transfer of TEDs technology to the government and industries in Malaysia, apart from participation by Malaysia in one regional workshop.

52. Malaysia's submissions on legal issues arising under Article XX(b) and Article XX(g) have been addressed by the Panel, at paragraphs 3.213, 3.218-3.221, 3.231, 3.233, 3.236, 3.240, 3.247, 3.257, 3.266, 3.271-3.275, 3.286-3.288 and 3.293 of the Panel Report.

<sup>55</sup> Adopted 16 January 1998, WT/DS50/AB/R.

<sup>56</sup> Adopted 7 November 1952, BISD 1S/59.

<sup>57</sup> Adopted 20 May 1996, WT/DS2/AB/R.

D. *Arguments of Third Participants*

1. Australia

53. Australia states that with respect to unsolicited submissions to the Panel by non-governmental organizations, the United States appears to suggest that the Panel's legal interpretation of the provisions of the DSU would limit the discretion the DSU affords to panels in choosing the sources of information they should consider. However, in the view of Australia, nothing in the Panel Report suggests that the Panel saw any legal obstacles to its requesting information from the non-governmental sources, if it had so wished. The decision of the Panel not to seek such information would appear to reflect the exercise of its discretion as provided by the DSU, and was not the result of any perceived legal obstacles. Australia notes that the United States has not claimed that the Panel's exercise of its discretion in this matter was inappropriate or involved an error in law.

54. Australia believes that the Panel correctly found that Section 609 constitutes "unjustifiable discrimination between countries where the same conditions prevail". However, Australia supports the appeal by the United States of the Panel's finding that Section 609 "is not within the scope of measures permitted under the chapeau of Article XX." Australia submits that the Appellate Body should complete the analysis under Article XX and find that the United States has not demonstrated that its measure is in conformity with Article XX, including the provisions of the chapeau. Australia's concerns are that the United States has sought to impose a unilaterally determined conservation measure through restrictions on trade, and has not explored the scope for working cooperatively with other countries to identify internationally shared concerns about sea turtle conservation issues and consider ways to address these concerns. Therefore, the United States has imposed Section 609 in a manner that constitutes unjustifiable discrimination between countries where the same conditions prevail and also a disguised restriction on international trade.

55. Australia agrees with the United States that the Panel failed to interpret the terms of the chapeau of Article XX requiring that measures not be applied in a manner which would constitute "a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail" in accordance with customary rules of interpretation of public international law, in particular, with its ordinary meaning and in context.

56. In Australia's view, the Panel's decision to examine first whether Section 609 met the requirements of the chapeau before considering whether it met the requirements of any of the paragraphs of Article XX may not necessarily have been an error in law, but contributed to the Panel's errors in its examination of Section 609 under Article XX. Australia argues that it is preferable to

begin examination of the legal issues raised by Article XX by considering the policy objective of the measure, and the connection between the policy objective and the measure, before turning to the chapeau. This approach would enable the examination of all aspects of the case that may be relevant in determining whether a particular measure meets the requirements of the chapeau. There is nothing in the wording of Article XX, read in its context and in the light of the object and purposes of the GATT 1994 and the *WTO Agreement*, to suggest that it is intended to exclude particular classes or types of measures from its coverage. The Panel erred in law in conducting this generalized inquiry. By its terms, Article XX would seem capable of application only on a case-by-case basis.

57. Article XX contains a series of tests designed to ensure that its provisions cannot be abused. There must be a presumption that a measure which meets the requirements of Article XX will not "undermine the WTO multilateral trading system." According to Australia, there is no textual basis for interpreting "unjustifiable discrimination" in such a broad manner that it becomes an independent test of this issue. Under the Panel's interpretation, the chapeau of Article XX could serve to nullify the effects of the paragraphs of that Article, rather than acting as a safeguard against their abuse.

58. Australia agrees with the United States that the Panel's interpretation of "unjustifiable discrimination" is based on an incorrect interpretation and application of the object and purpose of the *WTO Agreement* in construing the GATT 1994. The Panel has projected a view of the relationship between the objectives of the WTO multilateral trading system and environmental considerations which is at odds with the Ministerial Decision on Trade and Environment.<sup>58</sup>

59. At the same time, to Australia, the alternative interpretation of "unjustifiable discrimination" put forward by the United States -- i.e. that discrimination is not "unjustifiable" where the policy goal of the Article XX exemption being applied provides a rationale for the justification -- is in error. This interpretation would weaken the important safeguard represented by the chapeau of Article XX of avoiding the abuse or illegitimate use of the Article XX exceptions. This interpretation confuses the tests applied under the two tiers of Article XX, fails to give effect to all the terms of the treaty and is not based on the ordinary meaning of "unjustifiable discrimination" in its context and in the light of the object and purpose of the *WTO Agreement* and the GATT 1994.

60. Australia maintains that Section 609 is applied by the United States in a manner constituting an unjustifiable discrimination and a disguised restriction on international trade. Australia observes that the only justification the United States appears to offer for Section 609 is that it is required to

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<sup>58</sup> Adopted by Ministers at the Meeting of the Trade Negotiations Committee at Marrakesh, 14 April 1994.

enforce a unilaterally determined conservation measure. However, Australia argues that the United States has not demonstrated that it has adequately explored means of addressing its concerns about shrimp harvesting practices and turtle conservation in other countries through cooperation with the governments concerned.

61. It is the view of Australia that Section 609 does not reasonably and properly differentiate between countries based on the risks posed to sea turtles in the exporting country's shrimp fishery. The Panel focused on exports of wild shrimp, and it is misleading to suggest that the Panel drew conclusions about whether the same conditions prevailed in certain other circumstances with respect to shrimp not subject to the import prohibition. Furthermore, the United States has provided no evidence that it took into account the views of other countries about sea turtle conservation issues within their jurisdictions, or their respective national programs, in making its determination of "countries where the same conditions prevail". In particular, the United States has provided no evidence that it considered the possibility that other Members may have had sea turtle conservation programs in place which differed from that of the United States but which were comparable and appropriate for their circumstances. Australia argues that the United States refused to certify Australia under Section 609 even though Australia's sea turtle conservation regime "extends well beyond protecting turtles from shrimping nets and ... includes cooperative programs with the shrimp industry to limit turtle bycatch."

62. In Australia's view, the legal obligations of the United States under the chapeau of Article XX required the United States to explore adequately means of mitigating the discriminatory and trade restrictive application of its measure. In particular, given the transboundary and global character of the environmental concern involved in this dispute, the United States should have consulted with affected Members to see whether the discrimination imposed by the measure in dispute could have been avoided, whether the restrictions on trade were required, whether alternative approaches were available, and whether the incidence of any trade measures could have been reduced.

## 2. Ecuador

63. Ecuador endorses the Panel's finding that Section 609 is inconsistent with Article XI:1 of the GATT 1994 and cannot be justified under Article XX of the GATT 1994. Ecuador is participating as a third party in this case in order to defend basic principles, such as the principle reaffirming that relations among states should be established on the basis of international law -- since it is unacceptable that one state impose its domestic policy objectives upon other states -- as well as the observance of more specific principles and aspects set forth in the agreements governing the

multilateral trading system. These include non-discrimination in national treatment, the protection of the environment and the implementation of environmental policy.

64. According to Ecuador, this dispute does not concern the desirability of implementing some kind of conservation policy, to which Ecuador attaches the utmost importance, but rather the manner in which such a policy should be implemented. It is unacceptable that internal legislation is applied in an arbitrary manner, creating a high degree of uncertainty, and consequently prejudice, in a sector that is central to Ecuador's national economy. Ecuador endorses the Panel's view that Members are free to establish their own environmental policies in a manner consistent with their WTO obligations.

## 3. European Communities

65. With respect to unsolicited submissions to a panel by non-governmental organizations, the European Communities asserts that Article 13 of the DSU clearly gives a panel the "pro-active discretion" to "seek" certain information that the panel believes may be relevant to the case at hand. In addition, non-governmental organizations are free to publish their views so that their opinion is heard by the general public, which could include the parties to a dispute, the WTO Secretariat or the members of a panel. However, the European Communities "wonders whether the text of the DSU could be interpreted so widely" as to give non-governmental organizations the right to file submissions directly to a panel.

66. The European Communities contends that Article 13 of the DSU "does not oblige panels to 'accept' non-requested information which was not 'sought' for the purposes of a dispute settlement procedure." Panels should therefore reject submissions from non-governmental organizations when the panel itself had not requested such submissions. However, in the view of the European Communities, if a panel were interested in the information contained in an *amicus curiae* brief from a non-governmental organization, it would have the right to request and receive (to "seek") exactly the same information as had first been sent to it in an unsolicited manner. The European Communities agrees with the Panel that a Member, party to a dispute, is free to put forward as part of its own submission, a submission of a non-governmental organization that it considers relevant. The European Communities notes that its comments are based on the current language of Article 13 of the DSU.

67. The European Communities states further that the issues at stake in this dispute concern principles to which it attaches great importance, such as respect for the environment and the functioning of the multilateral trading system. The European Communities is bound by the text of the

Treaty Establishing the European Community<sup>59</sup> to ensure a harmonious and balanced development of economic activities with respect for the environment. The principle of sustainable development, also laid down in the first paragraph of the preamble to the *WTO Agreement*, as well as the precautionary principle, play an important role in the implementation of all EC policies. The EC position is mirrored in public international law by statements of the International Court of Justice, stressing the significance of respect for the environment.<sup>60</sup>

68. The European Communities is convinced that international cooperation is the most effective means to address global and transboundary environmental problems, rather than unilateral measures which may be less environmentally effective and more trade disruptive. Economic performance and environmental performance are not necessarily incompatible. The European Communities asserts that "[w]hile countries have the sovereign right to design and implement their own environmental policies through the measures they consider appropriate to protect their domestic environment -- including the life and health of humans, animals and plants -- all countries have a responsibility to contribute to the solution of international environmental problems." Thus, the European Communities considers that "in general, the most effective means to attain the shared objectives relating to the conservation of global resources is by proceeding through the process of international co-operation."

69. To the European Communities, the approach to Article XX developed by previous panels and followed by the Appellate Body in *United States - Gasoline*<sup>61</sup> -- that is, first examining whether a measure falls under one of the exceptions set out in paragraphs (a) to (j) of Article XX and, then, making an inquiry under the chapeau -- makes logical sense and could reasonably have been applied by the Panel in this case.

70. The European Communities agrees with the United States that it would be wrong for trade concerns to prevail over all other concerns in all situations under WTO rules. Article XX should not be construed so that trade concerns always prevail over the non-trade concerns reflected in that Article, including environmental concerns and those related to health and other legitimate policy objectives. It is up to panels and the Appellate Body to judge each case on its own merits, taking into account Members' rights and obligations.

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<sup>59</sup>Done at Rome, 25 March 1957, as amended.

<sup>60</sup>The European Communities refers to: *Legality of the Threat or Use of Nuclear Weapons*, Advisory Opinion, (1996), I.C.J.Rep. pp.241-242, para.29; *Case Concerning the Gabčíkovo-Nagymaros Project*, (1998) 37 International Legal Materials 162, para. 140.

<sup>61</sup>Adopted 20 May 1996, WT/DS2/AB/R.

71. The European Communities also agrees with the United States that the adoption of the Panel's "test" -- namely, whether a measure is of a type that would threaten the security and predictability of the multilateral trading system -- would make trade concerns paramount to all other concerns and is thus inconsistent with the object and purpose of the *WTO Agreement*.

72. In the view of the European Communities, certain species, in particular migratory species, may require application of protective measures beyond usual territorial boundaries. Sea turtles should be considered a globally shared environmental resource because they are included in Annex I of CITES and are a species protected under the Convention on the Conservation of Migratory Species of Wild Animals.<sup>62</sup> The appropriate way for Members concerned with the preservation of globally shared environmental resources to ensure such preservation is through internationally agreed solutions. Measures taken pursuant to such multilateral agreements would in general be allowed under the chapeau of Article XX.

73. However, the European Communities would not want to exclude the possibility, as a last resort, for a WTO Member, on its own, to take a "reasonable" measure with the aim of protecting and preserving a particular global environmental resource. However, such a measure would only be justified under exceptional circumstances and if consistent with general principles of public international law on "prescriptive jurisdiction". The Member would have to demonstrate that its environmentally protective measure was "reasonable", that is, no more trade restrictive than required to protect the globally shared environmental resource. Such a measure should be directly connected to the environmental objective and not go beyond what was required to limit the environmental damage. Finally, in such a case, the Member should have made genuine efforts to enter into cooperative environmental agreements with other Members. This is consistent with Principle 12 of the Rio Declaration on Environment and Development.

74. Given the Panel's factual finding that the United States did not enter into negotiations with the appellees before it imposed the import ban, the European Communities concludes that the United States has not demonstrated that a negotiated solution in respect of measures to protect sea turtles could not be found.

#### 4. Hong Kong, China

75. Hong Kong, China states that it would be a "serious misunderstanding of the role of the WTO" if the multilateral trading system were viewed as impervious to environmental concerns. The

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<sup>62</sup>Done at Bonn, 23 June 1979, 19 International Legal Materials 15.

WTO system does not, and should not, impede the adoption of non-arbitrary and justifiable measures to protect the environment. Hong Kong, China fully shares the Panel's concern that the chapeau of Article XX should not be interpreted in a way that will threaten the security and predictability of trade relations under the *WTO Agreement*. With reference to the Appellate Body Report in *United States – Gasoline*<sup>63</sup>, Hong Kong, China contends that an examination under the chapeau should focus on the manner in which the measure is applied, and answer the key question of whether the manner of application constitutes an abuse of the exceptions. Questions pertaining to the policy objective of the measure concerned should be set aside in examining the consistency of a measure with the chapeau.

76. Hong Kong, China argues that in line with the views of the Appellate Body in *United States – Gasoline*<sup>64</sup>, Article XX should not be read to establish an unqualified deviation from the GATT principle of non-discrimination. Taken together, the three elements of the chapeau of Article XX impose an obligation not to discriminate based on the origin of the product. With respect to "non-discrimination", the standard of obligation imposed by the chapeau is different from that imposed by Articles I and III of the GATT 1994, which is based on a strict interpretation of the concept of "like products". The chapeau of Article XX requires governments that intervene in order to achieve one of the objectives laid down in the sub-paragraphs of Article XX to ensure that the competitive conditions resulting from their intervention do not *de jure* or *de facto* favour their domestic products, nor the products of a certain specific origin. There should be no ambiguity about the exact content of the level of protection and the competitive conditions established as a result of government intervention. In the view of Hong Kong, China, a legal finding of inconsistency of a measure with the chapeau of Article XX is predicated on a factual finding that a particular measure does not respect the principle of non-discrimination. If this requirement is satisfied, a panel then can proceed to examine whether the requirements laid down in a sub-paragraph of Article XX have been satisfied as well.

77. Hong Kong, China contends that Section 609 violates the chapeau of Article XX to the extent that, after the October 1996 ruling of the United States Court of International Trade, shrimp caught by fishermen in uncertified countries are subject to the import ban even if they were caught with nets that are equipped with TEDs. The resulting competitive conditions show that Section 609 does not meet the requirement of no arbitrary or unjustifiable discrimination between countries where the same conditions prevail. In addition, the 1993 Guidelines removed the possibility available to foreign producers to use any form of fishing other than TEDs in shrimp harvesting to avoid the incidental taking of sea turtles. This would be consistent with the Article XX chapeau only if the use of TEDs is

<sup>63</sup> Adopted 20 May 1996, WT/DS2/AB/R, page 22.

<sup>64</sup> *Ibid.*

proven to be the sole means by which the stated objective can be achieved. Otherwise, it must be acknowledged that other means may exist whose effectiveness can be demonstrated to be comparable to TEDs, and the United States must give the same treatment to shrimp harvested with measures that exporters could demonstrate are comparable in effectiveness to TEDs. Failure to do so renders Section 609 a means of arbitrary and unjustifiable discrimination between countries where the same conditions prevail. If the Appellate Body finds it necessary to examine the measure in question under sub-paragraphs (b) and (g) of Article XX, Hong Kong, China invites the Appellate Body to consider its arguments submitted to the Panel and reflected in the Panel Report, in particular, at paragraphs 4.44 and 4.45.

5. Nigeria

78. Nigeria confirms its views expressed in paragraph 4.53 of the Panel Report and requests the Appellate Body to uphold the Panel's decision. Nigeria shares the concern about the conservation and protection of sea turtles but, however, objects to the methods and measures for doing so. Nigeria's position is defined by paragraphs 169 and 171 of the Report (1996) of the Committee on Trade and Environment.<sup>65</sup>

<sup>65</sup> Nigeria refers to WT/CTE/1, 12 November 1996. Paragraph 169 of the Report states: "WTO Member governments are committed not to introduce WTO-inconsistent or protectionist trade restrictions or countervailing measures in an attempt to offset any real or perceived adverse domestic economic or competitiveness effects of applying environmental policies; not only would this undermine the open, equitable and non-discriminatory nature of the multilateral trading system, it would also prove counterproductive to meeting environmental objectives and promoting sustainable development. Equally, and bearing in mind the fact that governments have the right to establish their national environmental standards in accordance with their respective environmental and developmental conditions, needs and priorities, WTO Members note that it would be inappropriate for them to relax their existing national environmental standards or their enforcement in order to promote their trade. The CTE notes the statement in the 1995 Report on Trade and Environment to the OECD Council at Ministerial Level that there has been no evidence of a systematic relationship between existing environmental policies and competitiveness impacts, nor of countries deliberately resorting to low environmental standards to gain competitive advantages. The CTE welcomes similar policy statements made in other inter-governmental fora."

Paragraph 171 of the Report states: "The CTE notes that governments have endorsed in the results of the 1992 U.N. Conference on Environment and Development their commitment to Principle 12 of the *Rio Declaration* that "Unilateral actions to deal with environmental challenges outside the jurisdiction of the importing country should be avoided. Environmental measures addressing transboundary or global problems should, as far as possible, be based on an international consensus." There is a clear complementarity between this approach and the work of the WTO in seeking cooperative multilateral solutions to trade concerns. The CTE endorses and supports multilateral solutions based on international cooperation and consensus as the best and most effective way for governments to tackle environmental problems of a transboundary or global nature. WTO Agreements and multilateral environmental agreements (MEAs) are representative of efforts of the international community to pursue shared goals, and in the development of a mutually supportive relationship between them due respect must be afforded to both."

### III. Procedural Matters and Rulings

#### A. *Admissibility of the Briefs by Non-governmental Organizations Appended to the United States Appellant's Submission*

79. The United States attached to its appellant's submission, filed on 23 July 1998, three Exhibits, containing comments by, or "amicus curiae briefs" submitted by, the following three groups of non-governmental organizations<sup>66</sup>: 1. the Earth Island Institute; the Humane Society of the United States; and the Sierra Club; 2. the Center for International Environmental Law ("CIEL"); the Centre for Marine Conservation; the Environmental Foundation Ltd.; the Mangrove Action Project; the Philippine Ecological Network; Red Nacional de Accion Ecologica; and Sobrevivencia; and 3. the Worldwide Fund for Nature and the Foundation for International Environmental Law and Development. On 3 August 1998, CIEL *et al.* submitted a slightly revised version of their brief.

80. In their joint appellees' submission, filed on 7 August 1998, Joint Appellees object to these briefs appended to the appellant's submission, and request that the Appellate Body not consider these briefs. Joint Appellees argue that the appellant's submission, including its three Exhibits, is not in conformity with the stipulation in Article 17.6 of the DSU that an appeal "shall be limited to issues of law covered in the panel report and legal interpretations developed by the panel", nor with Rule 21(2) of the *Working Procedures for Appellate Review*. They ask the Appellate Body to reject as irrelevant the factual assertions made in certain paragraphs of the appellant's submission, as well as the factual information presented in the Exhibits. In their view, because of the incorporation of unauthorized material through the attachment of the Exhibits, the appellant's submission could no longer be considered a "precise statement" as required by Rule 21(2) of the *Working Procedures for Appellate Review*. Rather, a number of the factual and legal assertions contained in the Exhibits go beyond the position taken by the appellant, resulting in confusion concerning the exact nature and linkage between the appeal and the three Exhibits.

81. Joint Appellees state further that the submission of Exhibits that present the views of non-governmental organizations, as opposed to the views of the appellant Member, is not contemplated in, or authorized by, the DSU or the *Working Procedures for Appellate Review*. Such submissions were

not in conformity with Article 17.4 of the DSU, nor with Rule 28(1) of the *Working Procedures for Appellate Review*, which vests the discretion to request additional submissions with the Appellate Body. According to Joint Appellees, the decision of the appellant to attach the Exhibits to its submission gives rise both to contradictions and internal inconsistencies, and raises serious procedural and systemic problems. Joint Appellees maintain that by virtue of their incorporation into the appellant's submission, these pleadings are no longer "amicus curiae briefs", but instead have become a portion of the appellant's submission, and thus have also become what would appear to be the official United States position.

82. In its appellee's submission, also filed on 7 August 1998, Malaysia similarly urges the Appellate Body to rule that the three Exhibits appended to the United States appellant's submission are inadmissible in this appeal. Malaysia refers to its argument before the Panel that briefs from non-governmental organizations do not fall within Article 13 of the DSU. In addition, according to Malaysia, admission of the Exhibits would not be consonant with Article 17.6 of the DSU, or with Rule 21(2) of the *Working Procedures for Appellate Review*, as the United States appellant's submission and Exhibit 2 contain statements of facts. Moreover, Article 17.4 of the DSU only grants the right to make written and oral submissions to third parties. Articles 11 and 17.12 of the DSU are significant and serve to safeguard the admissibility of evidence before the Appellate Body. In the alternative, in the event the Appellate Body ruled that Exhibits 1-3 of the appellant's submission should be admitted, Malaysia submits rebuttals to each of the Exhibits.

83. On 11 August 1998, we issued a ruling on this preliminary procedural matter addressed to the participants and third participants, as follows:

We have decided to accept for consideration, insofar as they may be pertinent, the legal arguments made by the various non-governmental organizations in the three briefs attached as exhibits to the appellant's submission of the United States, as well as the revised version of the brief by the Center for International Environmental Law *et al.*, which was submitted to us on 3 August 1998. The reasons for our ruling will be given in the Appellate Body Report.

84. In the same ruling, we addressed the following questions to the appellant, the United States:

to what extent do you agree with or adopt any one or more of the legal arguments set out in the three briefs prepared by the non-governmental organizations and appended as exhibits to your appellant's submission? In particular, do you adopt the legal arguments stated therein relating to paragraphs (b) and (g) and the chapeau of Article XX of the GATT 1994?

<sup>66</sup>In respect of these Exhibits, the United States stated the following: "Encouraging the use of TEDs in order to promote sea turtle conservation is a matter of great importance to a number of nongovernmental environmental organizations. Three groups of these organizations – each with specialized expertise in conservation of sea turtles and other endangered species – have prepared submissions reflecting their respective independent views with respect to the use of TEDs and other issues. The United States is submitting these materials to the Appellate Body for its information attached hereto as U.S. Appellant Exhibits 1-3." United States appellant's submission, para. 2, footnote 1.

85. We asked the United States to respond in writing to these questions by 13 August 1998, and offered an opportunity to the appellees and the third participants to respond, by 17 August 1998, to the answer filed by the United States concerning which aspects of these briefs it accepted and endorsed as part of its appeal as well as to the legal arguments made in the briefs by the non-governmental organizations. We noted at the time that Malaysia had already done the latter in Exhibits 1 through 3 attached to its appellee's submission.

86. On 13 August 1998, the United States replied as follows:

The main U.S. submission reflects the views of the United States on the legal issues in this appeal. As explained in our appellant's submission, the three submissions prepared by non-governmental organizations reflect the independent views of those organizations ... These non-governmental organizations have a great interest, and specialized expertise, in sea turtle conservation and related matters. It is appropriate therefore that the Appellate Body be informed of those organizations' views. The United States is not adopting these views as separate matters to which the Appellate Body must respond.

The United States agrees with the legal arguments in the submissions of the non-governmental organizations to the extent those arguments concur with the U.S. arguments set out in our main submission ....

87. On 17 August 1998, Joint Appellees filed a joint response, and Malaysia filed a separate one, to the matters raised in the reply of the United States, as well as in the Exhibits. Without prejudice to their view that the receipt and consideration by the Appellate Body of the briefs of non-governmental organizations attached to the appellant's submission is not authorized by the DSU or the *Working Procedures for Appellate Review*, Joint Appellees responded to certain legal arguments made in the briefs. Malaysia incorporated by reference its rebuttals to the briefs contained in its appellee's submission of 7 August 1998, and made certain additional comments in respect of each of the briefs. Also, on 17 August 1998, Hong Kong, China and Mexico filed statements in respect of the same matters. Hong Kong, China stated that the reply by the United States was unclear and that it was not possible, at that stage, to comment further on the legal arguments. For its part, Mexico stated that if the Appellate Body were to make use of arguments which are outside the terms of Article 17.6 of the DSU and which are not clearly and explicitly attributable to a Member that is a party to the dispute, the Appellate Body would exceed its powers under the DSU.

88. The admissibility of the briefs by certain non-governmental organizations which have been appended to the appellant's submission of the United States is a legal question raised by the appellees. This is a legal issue which does not relate to a finding of law made, or a legal interpretation developed, by the Panel in the Panel Report. For this reason, it has seemed appropriate to us to deal

with this issue separately from the issues raised by the appellant and addressed in the succeeding portions of this Appellate Body Report.

89. We consider that the attaching of a brief or other material to the submission of either appellant or appellee, no matter how or where such material may have originated, renders that material at least *prima facie* an integral part of that participant's submission. On the one hand, it is of course for a participant in an appeal to determine for itself what to include in its submission. On the other hand, a participant filing a submission is properly regarded as assuming responsibility for the contents of that submission, including any annexes or other attachments.

90. In the present appeal, the United States has made it clear that its views "on the legal issues in this appeal" are found in "the main U.S. submission." The United States has confirmed its agreement with the legal arguments in the attached submissions of the non-governmental organizations, to the extent that those arguments "concur with the U.S. arguments set out in [its] main submission."

91. We admit, therefore, the briefs attached to the appellant's submission of the United States as part of that appellant's submission. At the same time, considering that the United States has itself accepted the briefs in a tentative and qualified manner only, we focus in the succeeding sections below on the legal arguments in the main U.S. appellant's submission.

#### B. Sufficiency of the Notice of Appeal

92. In their joint appellee's submission, filed on 7 August 1998, Joint Appellees contend that the notice of appeal by the United States is defective in form and that the action is, therefore, not properly before the Appellate Body. They contend that the appellant's notice of appeal is both vague and cursory, and is, accordingly, not in compliance with the procedural requirements set forth in Rule 20(2)(d) of the *Working Procedures for Appellate Review*. It is also not a proper "submission" filed "within the required time periods" pursuant to Rule 29 of the *Working Procedures for Appellate Review*. As a result, it is argued, the United States' appeal should be dismissed by the Appellate Body on this ground alone. The appellant's notice of appeal does not identify any legal errors in a manner sufficient for the appellees to develop a defence, and this, in the appellees' view, made it impossible for them to discern the issues that were going to be the subject of the appeal until the appellant filed its written submission 10 days later. This reduced the time available for all appellees to draft their responsive submissions from 25 days to 15 days.

93. According to Joint Appellees, vague notices of appeal should not be tolerated for at least two reasons. First, considerations of fundamental fairness and good faith mandate that the appellant should not be permitted to gain a tactical advantage through its failure to fulfil the requirements of the *Working Procedures for Appellate Review*. Second, carefully considered and well-drafted submissions benefit the decision-making process of the Appellate Body.

94. The United States in turn submits that the notice of appeal provided just the type of "brief statement of the nature of the appeal, including the allegations of error in the issues of law covered in the panel report and legal interpretations developed by the panel" (emphasis in the original) called for in Rule 20(2)(d) of the *Working Procedures for Appellate Review*. First, the notice of appeal explained that the United States was appealing from the findings on issues of law and related legal interpretations leading to the panel's conclusion that the United States measure was outside the scope of the Article XX chapeau. Second, the notice of appeal stated that the United States was appealing the Panel's procedural finding that the Panel lacked discretion to accept materials received from non-governmental sources. The appellees did not explain what additional information they believed should have been included in the notice of appeal. Furthermore, according to the United States, the appellees' allegation of prejudice was unfounded. The appellees well knew the basic argument that the United States would present to support its claim of legal error. Indeed, the appellees themselves had pointed out that the United States appeal rests solely on one leg, that is, that the Panel created a "threat to the multilateral trading system" test, and that the United States already raised this same issue at the interim review stage. In short, the appeal did not result in any unfair surprise to the appellees.

95. Rule 20(2) of the *Working Procedures for Appellate Review* provides, in relevant part:

(2) A Notice of Appeal shall include the following information:

- ....
- (d) a *brief statement of the nature of the appeal, including the allegations of errors* in the issues of law covered in the panel report and legal interpretations developed by the panel.(emphasis added)

The *Working Procedures for Appellate Review* enjoin the appellant to be *brief* in its notice of appeal in setting out "the nature of the appeal, including the allegations of errors". We believe that, in principle, the "nature of the appeal" and "the allegations of errors" are sufficiently set out where the notice of appeal adequately identifies the findings or legal interpretations of the Panel which are being

appealed as erroneous. The notice of appeal is not expected to contain the reasons why the appellant regards those findings or interpretations as erroneous. The notice of appeal is not designed to be a summary or outline of the arguments to be made by the appellant. The legal arguments in support of the allegations of error are, of course, to be set out and developed in the appellant's submission.

96. In this instance, the notice of appeal does communicate the decision by the United States to appeal certain legal issues covered and certain legal interpretations developed in the Panel Report. The notice then refers to the two allegedly erroneous findings of the Panel being appealed from -- the finding that the United States measure at issue is not within the scope of measures permitted under the chapeau of Article XX; and the finding that accepting non-requested information from non-governmental sources is incompatible with the DSU. The notice did not cite the numbered paragraphs of the Panel Report containing the above findings, but Joint Appellees do not assert that that is necessary. The references in the notice of appeal to these two findings of the Panel are terse<sup>67</sup>, but there is no mistaking which findings or interpretations of the Panel the Appellate Body is asked to review. We accordingly hold that the notice of appeal by the United States meets the requirements of Rule 20(2)(d) of the *Working Procedures for Appellate Review*, and deny the request of Joint Appellees to dismiss the entire appeal summarily on the sole ground of insufficiency of the notice of appeal.

97. It remains only to recall that the right of a party to appeal from legal findings and legal interpretations reached by a panel in a dispute settlement proceeding is an important new right established in the DSU resulting from the Uruguay Round. We believe that the provisions of Rule 20(2) and other Rules of the *Working Procedures for Appellate Review* are most appropriately read so as to give full meaning and effect to the right of appeal and to give a party which regards itself aggrieved by some legal finding or interpretation in a panel report a real and effective opportunity to demonstrate the error in such finding or interpretation. It is scarcely necessary to add that an appellee is, of course, always entitled to its full measure of due process. In the present appeal, perhaps the best indication that that full measure of due process was not in any degree impaired by the notice of appeal filed by the United States, is the developed and substantial nature of the appellees' submissions.

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<sup>67</sup>The interpretation of the Panel concerning non-requested information, and its finding on the inconsistency of Section 609 with Article XX of the GATT 1994, are themselves cast in fairly terse language; Panel Report, paras. 7.8, fourth sentence, 7.49 and 7.62.

#### IV. Issues Raised in This Appeal

98. The issues raised in this appeal by the appellant, the United States, are the following:

- (a) whether the Panel erred in finding that accepting non-requested information from non-governmental sources would be incompatible with the provisions of the DSU as currently applied; and
- (b) whether the Panel erred in finding that the measure at issue constitutes unjustifiable discrimination between countries where the same conditions prevail and thus is not within the scope of measures permitted under Article XX of the GATT 1994.

#### V. Panel Proceedings and Non-requested Information

99. In the course of the proceedings before the Panel, on 28 July 1997, the Panel received a brief from the Center for Marine Conservation ("CMC") and the Center for International Environmental Law ("CIEL"). Both are non-governmental organizations. On 16 September 1997, the Panel received another brief, this time from the World Wide Fund for Nature. The Panel acknowledged receipt of the two briefs, which the non-governmental organizations also sent directly to the parties to this dispute. The complaining parties -- India, Malaysia, Pakistan and Thailand -- requested the Panel not to consider the contents of the briefs in dealing with the dispute. In contrast, the United States urged the Panel to avail itself of any relevant information in the two briefs, as well as in any other similar communications.<sup>68</sup> The Panel disposed of this matter in the following manner:

*We had not requested such information as was contained in the above-mentioned documents. We note that, pursuant to Article 13 of the DSU, the initiative to seek information and to select the source of information rests with the Panel. In any other situations, only parties and third parties are allowed to submit information directly to the Panel. Accepting non-requested information from non-governmental sources would be, in our opinion, incompatible with the provisions of the DSU as currently applied. We therefore informed the parties that we did not intend to take these documents into consideration. We observed, moreover, that it was usual practice for parties to put forward whatever documents they considered relevant to support their case and that, if any party in the present dispute wanted to put forward these documents, or parts of them, as part of their own submissions to the Panel, they were free to do so. If this were the case, the other parties would have two weeks to respond to the additional material.* We noted that the United States availed themselves of this opportunity by designating Section III of the document submitted by the Center for Marine Conservation and the Center for International Environmental Law as an annex to its second submission to the Panel.<sup>69</sup> (emphasis added)

100. We note that the Panel did two things. First, the Panel declared a legal interpretation of certain provisions of the DSU: i.e., that accepting non-requested information from non-governmental sources would be "incompatible with the provisions of the DSU as currently applied." Evidently as a result of this legal interpretation, the Panel announced that it would not take the briefs submitted by non-governmental organizations into consideration. Second, the Panel nevertheless allowed any party to the dispute to put forward the briefs, or any part thereof, as part of its own submissions to the Panel, giving the other party or parties, in such case, two additional weeks to respond to the additional material. The United States appeals from this legal interpretation of the Panel.

101. It may be well to stress at the outset that access to the dispute settlement process of the WTO is limited to Members of the WTO. This access is not available, under the *WTO Agreement* and the covered agreements as they currently exist, to individuals or international organizations, whether governmental or non-governmental. Only Members may become parties to a dispute of which a panel may be seized, and only Members "having a substantial interest in a matter before a panel" may become third parties in the proceedings before that panel.<sup>70</sup> Thus, under the DSU, only Members who are parties to a dispute, or who have notified their interest in becoming third parties in such a dispute to the DSB, have a *legal right* to make submissions to, and have a *legal right* to have those

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<sup>69</sup>Panel Report, para. 7.8.

<sup>70</sup>See Articles 4, 6, 9 and 10 of the DSU.

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<sup>68</sup>Panel Report, para. 3.129

submissions considered by, a panel.<sup>71</sup> Correlatively, a panel is *obliged* in law to accept and give due consideration only to submissions made by the parties and the third parties in a panel proceeding. These are basic legal propositions; they do not, however, dispose of the issue here presented by the appellant's first claim of error. We believe this interpretative issue is most appropriately addressed by examining what a panel is *authorized* to do under the DSU.

102. Article 13 of the DSU reads as follows:

*Article 13*  
*Right to Seek Information*

1. *Each panel shall have the right to seek information and technical advice from any individual or body which it deems appropriate.* However, before a panel seeks such information or advice from any individual or body within the jurisdiction of a Member it shall inform the authorities of that Member. *A Member should respond promptly and fully to any request by a panel for such information as the panel considers necessary and appropriate.* Confidential information which is provided shall not be revealed without formal authorization from the individual, body, or authorities of the Member providing the information.
2. *Panels may seek information from any relevant source and may consult experts to obtain their opinion on certain aspects of the matter.* With respect to a factual issue concerning a scientific or other technical matter raised by a party to a dispute, a panel may request an advisory report in writing from an expert review group. Rules for the establishment of such a group and its procedures are set forth in Appendix 4.(emphasis added)

103. In *EC Measures Affecting Meat and Meat Products (Hormones)*, we observed that Article 13 of the DSU<sup>72</sup> "enable[s] panels to seek information and advice as they deem appropriate in a particular case."<sup>73</sup> Also, in *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, we ruled that:

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<sup>71</sup>Articles 10 and 12, and Appendix 3 of the DSU. We note that Article 17.4 of the DSU limits the right to appeal a panel report to parties to a dispute, and permits third parties which have notified the DSB of their substantial interest in the matter to make written submissions to, and be given an opportunity to be heard by, the Appellate Body.

<sup>72</sup>As well as Article 11.2 of the *Agreement on the Application of Sanitary and Phytosanitary Measures*.

<sup>73</sup>Adopted 13 February 1998, WT/DS26/AB/R, WT/DS48/AB/R, para. 147.

Pursuant to Article 13.2 of the DSU, a panel may seek information from any relevant source and may consult experts to obtain their opinions on certain aspects of the matter at issue. *This is a grant of discretionary authority: a panel is not duty-bound to seek information in each and every case or to consult particular experts under this provision.* We recall our statement in *EC Measures Concerning Meat and Meat Products (Hormones)* that Article 13 of the DSU enables a panel to seek information and technical advice as it deems appropriate in a particular case, and that the DSU leaves "to the sound discretion of a panel the determination of whether the establishment of an expert review group is necessary or appropriate." *Just as a panel has the discretion to determine how to seek expert advice, so also does a panel have the discretion to determine whether to seek information or expert advice at all.*

...  
In this case, we find that the Panel acted within the bounds of its discretionary authority under Articles 11 and 13 of the DSU in deciding not to seek information from, nor to consult with, the IMF.<sup>74</sup> (emphasis added)

104. The comprehensive nature of the authority of a panel to "seek" information and technical advice from "any individual or body" it may consider appropriate, or from "any relevant source", should be underscored. This authority embraces more than merely the choice and evaluation of the source of the information or advice which it may seek. A panel's authority includes the authority to decide *not to seek* such information or advice at all. We consider that a panel also has the authority to *accept or reject* any information or advice which it may have sought and received, or to *make some other appropriate disposition* thereof. It is particularly within the province and the authority of a panel to determine *the need for information and advice* in a specific case, to ascertain the *acceptability and relevancy* of information or advice received, and to decide *what weight to ascribe to that information or advice* or to conclude that no weight at all should be given to what has been received.

105. It is also pertinent to note that Article 12.1 of the DSU authorizes panels to depart from, or to add to, the Working Procedures set forth in Appendix 3 of the DSU, and in effect to develop their own Working Procedures, after consultation with the parties to the dispute. Article 12.2 goes on to direct that "[p]anel procedures should provide *sufficient flexibility* so as to *ensure high-quality panel reports* while *not unduly delaying the panel process*." (emphasis added)

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<sup>74</sup>Adopted 22 April 1998, WT/DS56/AB/R, paras. 84-86.

106. The thrust of Articles 12 and 13, taken together, is that the DSU accords to a panel established by the DSB, and engaged in a dispute settlement proceeding, ample and extensive authority to undertake and to control the process by which it informs itself both of the relevant facts of the dispute and of the legal norms and principles applicable to such facts. That authority, and the breadth thereof, is indispensably necessary to enable a panel to discharge its duty imposed by Article 11 of the DSU to "make an objective assessment of the matter before it, including an *objective assessment of the facts of the case* and the *applicability of and conformity with the relevant covered agreements* . . . ." (emphasis added)

107. Against this context of broad authority vested in panels by the DSU, and given the object and purpose of the Panel's mandate as revealed in Article 11, we do not believe that the word "seek" must necessarily be read, as apparently the Panel read it, in too literal a manner. That the Panel's reading of the word "seek" is unnecessarily formal and technical in nature becomes clear should an "individual or body" first ask a panel for permission to file a statement or a brief. In such an event, a panel may decline to grant the leave requested. If, in the exercise of its sound discretion in a particular case, a panel concludes *inter alia* that it could do so without "unduly delaying the panel process", it could grant permission to file a statement or a brief, subject to such conditions as it deems appropriate. The exercise of the panel's discretion could, of course, and perhaps should, include consultation with the parties to the dispute. In this kind of situation, for all practical and pertinent purposes, the distinction between "requested" and "non-requested" information vanishes.

108. In the present context, authority to *seek* information is not properly equated with a *prohibition* on accepting information which has been submitted without having been requested by a panel. A panel has the discretionary authority either to accept and consider or to reject information and advice submitted to it, *whether requested by a panel or not*. The fact that a panel may *motu proprio* have initiated the request for information does not, by itself, bind the panel to accept and consider the information which is actually submitted. The amplitude of the authority vested in panels to shape the processes of fact-finding and legal interpretation makes clear that a panel will *not* be deluged, as it were, with non-requested material, *unless that panel allows itself to be so deluged*.

109. Moreover, acceptance and rejection of the information and advice of the kind here submitted to the Panel need not exhaust the universe of possible appropriate dispositions thereof. In the present case, the Panel did not reject the information outright. The Panel suggested instead, that, if any of the parties wanted "to put forward these documents, or parts of them, as part of their own submissions to

the Panel, they were free to do so."<sup>75</sup> In response, the United States then designated Section III of the document submitted by CIEL/CMC as an annex to its second submission to the Panel, and the Panel gave the appellees two weeks to respond. We believe that this practical disposition of the matter by the Panel in this dispute may be detached, as it were, from the legal interpretation adopted by the Panel of the word "seek" in Article 13.1 of the DSU. When so viewed, we conclude that the actual disposition of these briefs by the Panel does not constitute either legal error or abuse of its discretionary authority in respect of this matter. The Panel was, accordingly, entitled to treat and take into consideration the section of the brief that the United States appended to its second submission to the Panel, just like any other part of the United States pleading.

110. We find, and so hold, that the Panel erred in its legal interpretation that accepting non-requested information from non-governmental sources is incompatible with the provisions of the DSU. At the same time, we consider that the Panel acted within the scope of its authority under Articles 12 and 13 of the DSU in allowing any party to the dispute to attach the briefs by non-governmental organizations, or any portion thereof, to its own submissions.

## VI. Appraising Section 609 Under Article XX of the GATT 1994

111. We turn to the second issue raised by the appellant, the United States, which is whether the Panel erred in finding that the measure at issue<sup>76</sup> constitutes unjustifiable discrimination between countries where the same conditions prevail and, thus, is not within the scope of measures permitted under Article XX of the GATT 1994.

### A. *The Panel's Findings and Interpretative Analysis*

112. The Panel's findings, from which the United States appeals, and the gist of its supporting reasoning, are set forth below *in extenso*:

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<sup>75</sup>Panel Report, para. 7.8.

<sup>76</sup>The United States measure at issue is referred to in this Report as "Section 609" or "the measure". By these terms, we mean Section 609 and the 1996 Guidelines.

... [W]e are of the opinion that the *chapeau* [of] Article XX, interpreted within its context and in the light of the object and purpose of GATT and of the WTO Agreement, *only allows Members to derogate from GATT provisions so long as, in doing so, they do not undermine the WTO multilateral trading system*, thus also abusing the exceptions contained in Article XX. Such undermining and abuse would occur when a Member jeopardizes the operation of the WTO Agreement in such a way that guaranteed market access and nondiscriminatory treatment within a multilateral framework would no longer be possible. ... We are of the view that a *type of measure adopted by a Member* which, on its own, may appear to have a relatively minor impact on the multilateral trading system, *may nonetheless raise a serious threat to that system if similar measures are adopted by the same or other Members*. Thus, by allowing such type of measures even though their individual impact may not appear to be such as to threaten the multilateral trading system, one would affect the security and predictability of the multilateral trading system. We consequently find that when considering a measure under Article XX, we must determine not only whether the measure *on its own* undermines the WTO multilateral trading system, but also whether *such type of measure*, if it were to be adopted by other Members, would threaten the security and predictability of the multilateral trading system.<sup>77</sup>

In our view, if an interpretation of the *chapeau* of Article XX were to be followed which would allow a Member to *adopt measures conditioning access to its market for a given product upon the adoption by the exporting Members of certain policies, including conservation policies*, GATT 1994 and the WTO Agreement could no longer serve as a multilateral framework for trade among Members as security and predictability of trade relations under those agreements would be threatened. This follows because, if one WTO Member were allowed to adopt such measures, then other Members would also have the right to adopt similar measures on the same subject but with differing, or even conflicting, requirements. ... Market access for goods could become subject to an increasing number of conflicting policy requirements for the same product and this would rapidly lead to the end of the WTO multilateral trading system.<sup>78</sup>

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<sup>77</sup>Panel Report, para. 7.44.

<sup>78</sup>Panel Report, para. 7.45.

... Section 609, as applied, is a measure conditioning access to the US market for a given product on the adoption by exporting Members of conservation policies that the United States considers to be comparable to its own in terms of regulatory programmes and incidental taking.<sup>79</sup>

... it appears to us that, in light of the context of the term "unjustifiable" and the object and purpose of the WTO Agreement, *the US measure at issue constitutes unjustifiable discrimination* between countries where the same conditions prevail and thus is not within the scope of measures permitted under Article XX.<sup>80</sup>

...

We therefore find that *the US measure at issue is not within the scope of measures permitted under the chapeau of Article XX*.<sup>81</sup> (emphasis added)

113. Article XX of the GATT 1994 reads, in its relevant parts:

Article XX

*General Exceptions*

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 Member of measures:

...

- (b) necessary to protect human, animal or plant life or health;
- ...
- (g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption;

114. The Panel did not follow all of the steps of applying the "customary rules of interpretation of public international law" as required by Article 3.2 of the DSU. As we have emphasized numerous

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<sup>79</sup>Panel Report, para. 7.48.

<sup>80</sup>Panel Report, para. 7.49.

<sup>81</sup>Panel Report, para. 7.62.

times<sup>82</sup>, these rules call for an examination of the ordinary meaning of the words of a treaty, read in their context, and in the light of the object and purpose of the treaty involved. A treaty interpreter must begin with, and focus upon, the text of the particular provision to be interpreted. It is in the words constituting that provision, read in their context, that the object and purpose of the states parties to the treaty must first be sought. Where the meaning imparted by the text itself is equivocal or inconclusive, or where confirmation of the correctness of the reading of the text itself is desired, light from the object and purpose of the treaty as a whole may usefully be sought.<sup>83</sup>

115. In the present case, the Panel did not expressly examine the ordinary meaning of the words of Article XX. The Panel disregarded the fact that the introductory clauses of Article XX speak of the "manner" in which measures sought to be justified are "applied". In *United States - Gasoline*, we pointed out that the chapeau of Article XX "by its express terms addresses, not so much the questioned measure or its specific contents as such, but rather the manner in which that measure is applied."<sup>84</sup>(emphasis added) The Panel did not inquire specifically into how the application of Section 609 constitutes "a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade." What the Panel did, in purporting to examine the consistency of the measure with the chapeau of Article XX, was to focus repeatedly on the *design of the measure itself*. For instance, the Panel stressed that it was addressing "a particular situation where a Member has taken unilateral measures which, by their nature, could put the multilateral trading system at risk."<sup>85</sup> (emphasis added)

116. The general design of a measure, as distinguished from its application, is, however, to be examined in the course of determining whether that measure falls within one or another of the paragraphs of Article XX following the chapeau. The Panel failed to scrutinize the *immediate*

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<sup>82</sup>See, for example, the Appellate Body Reports in: *United States - Gasoline*, adopted 20 May 1996, WT/DS2/AB/R, p. 17; *Japan - Taxes on Alcoholic Beverages*, adopted 1 November 1996, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, pp. 10-12; *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products*, adopted 16 January 1998, WT/DS50/AB/R, paras. 45-46; *Argentina - Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, adopted 13 February 1998, WT/DS56/AB/R, para. 47; and *European Communities - Customs Classification of Certain Computer Equipment*, adopted 22 June 1998, WT/DS62/AB/R, WT/DS67/AB/R, WT/DS68/AB/R, para. 85.

<sup>83</sup>J. Sinclair, *The Vienna Convention on the Law of Treaties*, 2nd ed. (Manchester University Press, 1984), pp. 130-131.

<sup>84</sup>Adopted 20 May 1996, WT/DS2/AB/R, p. 22.

<sup>85</sup>Panel Report, para. 7.60. The Panel also stated, in paras. 7.33-7.34 of the Panel Report:  
... Pursuant to the chapeau of Article XX, a measure may discriminate, but not in an 'arbitrary' or 'unjustifiable' manner.

We therefore move to consider whether the US measure conditioning market access on the adoption of certain conservation policies by the exporting Member could be considered as 'unjustifiable' discrimination ... (emphasis added)

context of the chapeau: i.e., paragraphs (a) to (j) of Article XX. Moreover, the Panel did not look into the object and purpose of the *chapeau of Article XX*. Rather, the Panel looked into the object and purpose of the *whole of the GATT 1994 and the WTO Agreement*, which object and purpose it described in an overly broad manner. Thus, the Panel arrived at the very broad formulation that measures which "undermine the WTO multilateral trading system"<sup>86</sup> must be regarded as "not within the scope of measures permitted under the chapeau of Article XX."<sup>87</sup> Maintaining, rather than undermining, the multilateral trading system is necessarily a fundamental and pervasive premise underlying the *WTO Agreement*; but it is not a right or an obligation, nor is it an interpretative rule which can be employed in the appraisal of a given measure under the chapeau of Article XX. In *United States - Gasoline*, we stated that it is "important to underscore that the purpose and object of the introductory clauses of Article XX is generally the prevention of 'abuse of the exceptions of [Article XX]'"<sup>88</sup>(emphasis added) The Panel did not attempt to inquire into how the measure at stake was being applied in such a manner as to constitute *abuse or misuse of a given kind of exception*.

117. The above flaws in the Panel's analysis and findings flow almost naturally from the fact that the Panel disregarded the sequence of steps essential for carrying out such an analysis. The Panel defined its approach as first "determin[ing] whether the measure at issue satisfies the conditions contained in the chapeau."<sup>89</sup> If the Panel found that to be the case, it said that it "shall then examine whether the US measure is covered by the terms of Article XX(b) or (g)."<sup>90</sup> The Panel attempted to justify its interpretative approach in the following manner:

As mentioned by the Appellate Body in its report in the *Gasoline* case, in order for the justification of Article XX to be extended to a given measure, it must not only come under one or another of the particular exceptions - paragraphs (a) to (j) - listed under Article XX; it must also satisfy the requirements imposed by the opening clause of Article XX. We note that panels have in the past considered the specific paragraphs of Article XX before reviewing the applicability of the conditions contained in the chapeau. However, as the conditions contained in the introductory provision apply to any of the paragraphs of Article XX, it seems equally appropriate to analyse first the introductory provision of Article XX.<sup>91</sup>(emphasis added)

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<sup>86</sup>See, for example, Panel Report, para. 7.44.

<sup>87</sup>Panel Report, para. 7.62.

<sup>88</sup>Adopted 20 May 1996, WT/DS2/AB/R, p. 22.

<sup>89</sup>Panel Report, para. 7.29.

<sup>90</sup>*Ibid.*

<sup>91</sup>Panel Report, para. 7.28.

118. In *United States - Gasoline*, we enunciated the appropriate method for applying Article XX of the GATT 1994:

In order that the justifying protection of Article XX may be extended to it, the measure at issue must not only come under one or another of the particular exceptions -- paragraphs (a) to (j) -- listed under Article XX; it must also satisfy the requirements imposed by the opening clauses of Article XX. *The analysis is, in other words, two-tiered: first, provisional justification by reason of characterization of the measure under XX(g); second, further appraisal of the same measure under the introductory clauses of Article XX.*<sup>92</sup> (emphasis added)

119. The sequence of steps indicated above in the analysis of a claim of justification under Article XX reflects, not inadvertence or random choice, but rather the fundamental structure and logic of Article XX. The Panel appears to suggest, albeit indirectly, that following the indicated sequence of steps, or the inverse thereof, does not make any difference. To the Panel, reversing the sequence set out in *United States - Gasoline* "seems equally appropriate."<sup>93</sup> We do not agree.

120. The task of interpreting the chapeau so as to prevent the abuse or misuse of the specific exemptions provided for in Article XX is rendered very difficult, if indeed it remains possible at all, where the interpreter (like the Panel in this case) has not first identified and examined the specific exception threatened with abuse. The standards established in the chapeau are, moreover, necessarily broad in scope and reach: the prohibition of the *application* of a measure "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." (emphasis added) When applied in a particular case, the actual contours and contents of these standards will vary as the kind of measure under examination varies. What is appropriately characterizable as "arbitrary discrimination" or "unjustifiable discrimination", or as a "disguised restriction on international trade" in respect of one category of measures, need not be so with respect to another group or type of measures. The standard of "arbitrary discrimination", for example, under the chapeau may be different for a measure that purports to be necessary to protect public morals than for one relating to the products of prison labour.

121. The consequences of the interpretative approach adopted by the Panel are apparent in its findings. The Panel formulated a broad standard and a test for appraising measures sought to be justified under the chapeau; it is a standard or a test that finds no basis either in the text of the chapeau or in that of either of the two specific exceptions claimed by the United States. The Panel, in effect, constructed an *a priori* test that purports to define a category of measures which, *ratione*

<sup>92</sup>Adopted 20 May 1996, WT/DS2/AB/R, p. 22.

<sup>93</sup>Panel Report, para 7.28.

*matrimae*, fall outside the justifying protection of Article XX's chapeau.<sup>94</sup> In the present case, the Panel found that the United States measure at stake fell within that class of excluded measures because Section 609 conditions access to the domestic shrimp market of the United States on the adoption by exporting countries of certain conservation policies prescribed by the United States. It appears to us, however, that conditioning access to a Member's domestic market on whether exporting Members comply with, or adopt, a policy or policies unilaterally prescribed by the importing Member may, to some degree, be a common aspect of measures falling within the scope of one or another of the exceptions (a) to (j) of Article XX. Paragraphs (a) to (j) comprise measures that are recognized as *exceptions to substantive obligations* established in the GATT 1994, because the domestic policies embodied in such measures have been recognized as important and legitimate in character. It is not necessary to assume that requiring from exporting countries compliance with, or adoption of, certain policies (although covered in principle by one or another of the exceptions) prescribed by the importing country, renders a measure *a priori* incapable of justification under Article XX. Such an interpretation renders most, if not all, of the specific exceptions of Article XX inutile, a result abhorrent to the principles of interpretation we are bound to apply.

122. We hold that the findings of the Panel quoted in paragraph 112 above, and the interpretative analysis embodied therein, constitute error in legal interpretation and accordingly reverse them.

123. Having reversed the Panel's legal conclusion that the United States measure at issue "is not within the scope of measures permitted under the chapeau of Article XX"<sup>95</sup>, we believe that it is our duty and our responsibility to complete the legal analysis in this case in order to determine whether Section 609 qualifies for justification under Article XX. In doing this, we are fully aware of our jurisdiction and mandate under Article 17 of the DSU. We have found ourselves in similar situations on a number of occasions. Most recently, in *European Communities - Measures Affecting the Importation of Certain Poultry Products*, we stated:

In certain appeals, ... the reversal of a panel's finding on a legal issue may require us to make a finding on a legal issue which was not addressed by the panel.<sup>96</sup>

In that case, having reversed the panel's finding on Article 5.1(b) of the *Agreement on Agriculture*, we completed the legal analysis by making a finding on the consistency of the measure at issue with Article 5.5 of the *Agreement on Agriculture*. Similarly, in *Canada - Certain Measures Concerning*

<sup>94</sup>See, for example, Panel Report, para. 7.50.

<sup>95</sup>Panel Report, para. 7.62.

<sup>96</sup>Adopted 23 July 1998, WT/DS69/AB/R, para. 156.

*Periodicals*<sup>97</sup>, having reversed the panel's findings on the issue of "like products" under the first sentence of Article III:2 of the GATT 1994, we examined the consistency of the measure with the second sentence of Article III:2. And, in *United States – Gasoline*<sup>98</sup>, having reversed the panel's findings on the first part of Article XX(g) of the GATT 1994, we completed the analysis of the terms of Article XX(g), and then examined the application of the measure at issue in that case under the chapeau of Article XX.

124. As in those previous cases, we believe it is our responsibility here to examine the claim by the United States for justification of Section 609 under Article XX in order properly to resolve this dispute between the parties. We do this, in part, recognizing that Article 3.7 of the DSU emphasizes that: "The aim of the dispute settlement mechanism is to secure a positive solution to a dispute." Fortunately, in the present case, as in the mentioned previous cases, we believe that the facts on the record of the panel proceedings permit us to undertake the completion of the analysis required to resolve this dispute.

B. *Article XX(g): Provisional Justification of Section 609*

125. In claiming justification for its measure, the United States primarily invokes Article XX(g). Justification under Article XX(b) is claimed only in the alternative; that is, the United States suggests that we should look at Article XX(b) only if we find that Section 609 does not fall within the ambit of Article XX(g).<sup>99</sup> We proceed, therefore, to the first tier of the analysis of Section 609 and to our consideration of whether it may be characterized as provisionally justified under the terms of Article XX(g).

126. Paragraph (g) of Article XX covers measures:

relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption;

I. "Exhaustible Natural Resources"

127. We begin with the threshold question of whether Section 609 is a measure concerned with the conservation of "exhaustible natural resources" within the meaning of Article XX(g). The Panel, of

<sup>97</sup> Adopted 30 July 1997, WT/DS31/AB/R, pp. 23 and 24.

<sup>98</sup> Adopted 20 May 1996, WT/DS2/AB/R, pp. 19 ff.

<sup>99</sup> Additional submission of the United States, dated 17 August, 1998, para. 5.

course, with its "chapeau-down" approach, did not make a finding on whether the sea turtles that Section 609 is designed to conserve constitute "exhaustible natural resources" for purposes of Article XX(g). In the proceedings before the Panel, however, the parties to the dispute argued this issue vigorously and extensively. India, Pakistan and Thailand contended that a "reasonable interpretation" of the term "exhaustible" is that the term refers to "finite resources such as minerals, rather than biological or renewable resources."<sup>100</sup> In their view, such finite resources were exhaustible "because there was a limited supply which could and would be depleted unit for unit as the resources were consumed."<sup>101</sup> Moreover, they argued, if "all" natural resources were considered to be exhaustible, the term "exhaustible" would become superfluous.<sup>102</sup> They also referred to the drafting history of Article XX(g), and, in particular, to the mention of minerals, such as manganese, in the context of arguments made by some delegations that "export restrictions" should be permitted for the preservation of scarce natural resources.<sup>103</sup> For its part, Malaysia added that sea turtles, being living creatures, could only be considered under Article XX(b), since Article XX(g) was meant for "nonliving exhaustible natural resources".<sup>104</sup> It followed, according to Malaysia, that the United States cannot invoke both the Article XX(b) and the Article XX(g) exceptions simultaneously.<sup>105</sup>

128. We are not convinced by these arguments. Textually, Article XX(g) is *not* limited to the conservation of "mineral" or "non-living" natural resources. The complainants' principal argument is rooted in the notion that "living" natural resources are "renewable" and therefore cannot be "exhaustible" natural resources. We do not believe that "exhaustible" natural resources and "renewable" natural resources are mutually exclusive. One lesson that modern biological sciences teach us is that living species, though in principle, capable of reproduction and, in that sense, "renewable", are in certain circumstances indeed susceptible of depletion, exhaustion and extinction, frequently because of human activities. Living resources are just as "finite" as petroleum, iron ore and other non-living resources.<sup>106</sup>

<sup>100</sup> Panel Report, para. 3.237.

<sup>101</sup> *Ibid.*

<sup>102</sup> *Ibid.*

<sup>103</sup> Panel Report, para. 3.238. India, Pakistan and Thailand referred, *inter alia*, to E/PC/T/C.II/QR/PV/5, 18 November 1946, p. 79.

<sup>104</sup> Panel Report, para. 3.240.

<sup>105</sup> *Ibid.*

<sup>106</sup> We note, for example, that the World Commission on Environment and Development stated: "The planet's species are under stress. There is growing scientific consensus that species are disappearing at rates never before witnessed on the planet ... ." World Commission on Environment and Development, *Our Common Future* (Oxford University Press, 1987), p. 13.

129. The words of Article XX(g), "exhaustible natural resources", were actually crafted more than 50 years ago. They must be read by a treaty interpreter in the light of contemporary concerns of the community of nations about the protection and conservation of the environment. While Article XX was not modified in the Uruguay Round, the preamble attached to the *WTO Agreement* shows that the signatories to that Agreement were, in 1994, fully aware of the importance and legitimacy of environmental protection as a goal of national and international policy. The preamble of the *WTO Agreement* -- which informs not only the GATT 1994, but also the other covered agreements -- explicitly acknowledges "the objective of sustainable development"<sup>107</sup> n.

The *Parties* to this Agreement,

*Recognizing that their relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development, ...*<sup>108</sup> (emphasis added)

130. From the perspective embodied in the preamble of the *WTO Agreement*, we note that the generic term "natural resources" in Article XX(g) is not "static" in its content or reference but is rather "by definition, evolutionary".<sup>109</sup> It is, therefore, pertinent to note that modern international conventions and declarations make frequent references to natural resources as embracing both living and non-living resources. For instance, the 1982 United Nations Convention on the Law of the

<sup>107</sup>This concept has been generally accepted as integrating economic and social development and environmental protection. See e.g., G. Handl, "Sustainable Development: General Rules versus Specific Obligations", in *Sustainable Development and International Law* (ed. W. Lang, 1995), p. 35; World Commission on Environment and Development, *Our Common Future* (Oxford University Press, 1987), p. 43.

<sup>108</sup>Preamble of the *WTO Agreement*.

<sup>109</sup>See *Namibia (Legal Consequences) Advisory Opinion* (1971) I.C.J. Rep., p. 31. The International Court of Justice stated that where concepts embodied in a treaty are "by definition, evolutionary", their "interpretation cannot remain unaffected by the subsequent development of law. . . . Moreover, an international instrument has to be interpreted and applied within the framework of the entire legal system prevailing at the time of the interpretation." See also *Aegean Sea Continental Shelf Case*, (1978) I.C.J. Rep., p. 3; Jennings and Watts (eds.), *Oppenheim's International Law*, 9th ed., Vol. I (Longman's, 1992), p. 1282 and E. Jimenez de Arechaga, "International Law in the Past Third of a Century", (1978-1) 159 *Recueil des Cours* 1, p. 49.

Sea<sup>110</sup> ("UNCLOS"), in defining the jurisdictional rights of coastal states in their exclusive economic zones, provides:

*Article 56*

*Rights, jurisdiction and duties of the coastal State in the exclusive economic zone*

1. In the exclusive economic zone, the coastal State has:
  - (a) sovereign rights for the purpose of exploring and exploiting, conserving and managing the *natural resources, whether living or non-living*, of the waters superjacent to the sea-bed and of the sea-bed and its subsoil, ... (emphasis added)

The UNCLOS also repeatedly refers in Articles 61 and 62 to "living resources" in specifying rights and duties of states in their exclusive economic zones. The Convention on Biological Diversity<sup>111</sup> uses the concept of "biological resources". Agenda 21<sup>112</sup> speaks most broadly of "natural resources" and goes into detailed statements about "marine living resources". In addition, the Resolution on Assistance to Developing Countries, adopted in conjunction with the Convention on the Conservation of Migratory Species of Wild Animals, recites:

Conscious that an important element of development lies in the conservation and management of *living natural resources* and that migratory species constitute a significant part of these resources;  
...<sup>113</sup> (emphasis added)

<sup>110</sup>Done at Montego Bay, 10 December 1982, UN Doc. A/CONF.62/122; 21 International Legal Materials 1261. We note that India, Malaysia and Pakistan have ratified the UNCLOS. Thailand has signed, but not ratified the Convention, and the United States has not signed the Convention. In the oral hearing, the United States stated: "... we have not ratified this Convention although, with respect to fisheries law, for the most part we do believe that UNCLOS reflects international customary law." Also see, for example, W. Burke, *The New International Law of Fisheries* (Clarendon Press, 1994), p. 40:

[the] coastal state sovereign rights over fisheries in a 200-mile zone are now considered part of customary international law. The evidence of state practice supporting this derives not only from the large number of coastal states claiming an EEZ [exclusive economic zone] in which such rights are advanced, but also from the fact that many of those states not claiming an EEZ assert rights not appreciably different than those in an EEZ. The provision for sovereign rights of the coastal state in [Article 56.1(a) of] the 1982 Convention is also a part of this evidence, but has particular weight because of the uniformity of state practice outside the Convention.

<sup>111</sup>Done at Rio de Janeiro, 5 June 1992, UNEP/Bio.Div./N7-INC5/4; 31 International Legal Materials 818. We note that India, Malaysia and Pakistan have ratified the Convention on Biological Diversity, and that Thailand and the United States have signed but not ratified the Convention.

<sup>112</sup>Adopted by the United Nations Conference on Environment and Development, 14 June 1992, UN Doc. A/CONF.151/26/Rev.1. See, for example, para. 17.70, ff.

<sup>113</sup>Final Act of the Conference to Conclude a Convention on the Conservation of Migratory Species of Wild Animals, done at Bonn, 23 June 1979, 19 International Legal Materials 11, p. 15. We note that India and Pakistan have ratified the Convention on the Conservation of Migratory Species of Wild Animals, but that Malaysia, Thailand and the United States are not parties to the Convention.

131. Given the recent acknowledgement by the international community of the importance of concerted bilateral or multilateral action to protect living natural resources, and recalling the explicit recognition by WTO Members of the objective of sustainable development in the preamble of the *WTO Agreement*, we believe it is too late in the day to suppose that Article XX(g) of the GATT 1994 may be read as referring only to the conservation of exhaustible mineral or other non-living natural resources.<sup>114</sup> Moreover, two adopted GATT 1947 panel reports previously found fish to be an "exhaustible natural resource" within the meaning of Article XX(g).<sup>115</sup> We hold that, in line with the principle of effectiveness in treaty interpretation<sup>116</sup>, measures to conserve exhaustible natural resources, whether *living* or *non-living*, may fall within Article XX(g).

132. We turn next to the issue of whether the living natural resources sought to be conserved by the measure are "exhaustible" under Article XX(g). That this element is present in respect of the five species of sea turtles here involved appears to be conceded by all the participants and third participants in this case. The exhaustibility of sea turtles would in fact have been very difficult to controvert since all of the seven recognized species of sea turtles are today listed in Appendix I of the Convention on International Trade in Endangered Species of Wild Fauna and Flora ("CITES"). The list in Appendix I includes "all species *threatened with extinction* which are or may be affected by trade."<sup>117</sup> (emphasis added)

133. Finally, we observe that sea turtles are highly migratory animals, passing in and out of waters subject to the rights of jurisdiction of various coastal states and the high seas. In the Panel Report, the Panel said:

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<sup>114</sup>Furthermore, the drafting history does not demonstrate an intent on the part of the framers of the GATT 1947 to exclude "living" natural resources from the scope of application of Article XX(g).

<sup>115</sup>*United States – Prohibition of Imports of Tuna and Tuna Products from Canada*, adopted 22 February 1982, BISD 29S/91, para. 4.9; *Canada – Measures Affecting Exports of Unprocessed Herring and Salmon*, adopted 22 March 1988, BISD 35S/98, para. 4.4.

<sup>116</sup>See the following Appellate Body Reports: *United States – Gasoline*, adopted 20 May 1996, WT/DS2/AB/R, p. 23; *Japan – Taxes on Alcoholic Beverages*, adopted 1 November 1996, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, p. 12; and *United States – Restrictions on Imports of Cotton and Man-made Fibre Underwear*, adopted 25 February 1997, WT/DS24/AB/R, p. 16. See also Jennings and Watts (eds.), *Oppenheim's International Law*, 9th ed., Vol. 1 (Longman's, 1992), pp. 1280-1281; M.S. McDougal, H.D. Lasswell and J. Miller, *The Interpretation of International Agreements and World Public Order: Principles of Content and Procedure* (New Haven/Martins Nijhoff, 1994), p. 184; I. Sinclair, *The Vienna Convention on the Law of Treaties*, 2nd ed. (Manchester University Press, 1984), p. 118; D. Carreau, *Droit International* (Editions A. Pedone, 1994), para. 369; P. Daillier and A. Pellet, *Droit International Public*, 5th ed. (L.G.D.J., 1994), para. 172; L.A. Podesta Costa and J.M. Ruda, *Derecho Internacional Público* (Tipografía Editora Argentina, 1985), pp. 109-110 and M. Diez de Velasco, *Instituciones de Derecho Internacional Público*, 11th ed. (Tecnos, 1997), p. 169.

<sup>117</sup>CITES, Article II.1.

... Information brought to the attention of the Panel, including documented statements from the experts, tends to confirm the fact that sea turtles, in certain circumstances of their lives, migrate through the waters of several countries and the high sea. ...<sup>118</sup> (emphasis added)

The sea turtle species here at stake, i.e., covered by Section 609, are all known to occur in waters over which the United States exercises jurisdiction.<sup>119</sup> Of course, it is not claimed that all populations of these species migrate to, or traverse, at one time or another, waters subject to United States jurisdiction. Neither the appellant nor any of the appellees claims any rights of exclusive ownership over the sea turtles, at least not while they are swimming freely in their natural habitat -- the oceans. We do not pass upon the question of whether there is an implied jurisdictional limitation in Article XX(g), and if so, the nature or extent of that limitation. We note only that in the specific circumstances of the case before us, there is a sufficient nexus between the migratory and endangered marine populations involved and the United States for purposes of Article XX(g).

134. For all the foregoing reasons, we find that the sea turtles here involved constitute "exhaustible natural resources" for purposes of Article XX(g) of the GATT 1994.

2. "Relating to the Conservation of Exhaustible Natural Resources"

135. Article XX(g) requires that the measure sought to be justified be one which "relat[es] to" the conservation of exhaustible natural resources. In making this determination, the treaty interpreter essentially looks into the relationship between the measure at stake and the legitimate policy of conserving exhaustible natural resources. It is well to bear in mind that the policy of protecting and conserving the endangered sea turtles here involved is shared by all participants and third participants in this appeal, indeed, by the vast majority of the nations of the world.<sup>120</sup> None of the parties to this dispute question the genuineness of the commitment of the others to that policy.<sup>121</sup>

136. In *United States – Gasoline*, we inquired into the relationship between the baseline establishment rules of the United States Environmental Protection Agency (the "EPA") and the

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<sup>118</sup>Panel Report, para. 7.53.

<sup>119</sup>See Panel Report, para. 2.6. The 1987 Regulations, 52 Fed. Reg. 24244, 29 June 1987, identified five species of sea turtles as occurring within the areas concerned and thus falling under the regulations: loggerhead (*Caretta caretta*), Kemp's ridley (*Lepidochelys kempi*), green (*Chelonia mydas*), leatherback (*Dermochelys coriacea*) and hawksbill (*Eretmochelys imbricata*). Section 609 refers to "those species of sea turtles the conservation of which is the subject of regulations promulgated by the Secretary of Commerce on 29 June, 1987."

<sup>120</sup>There are currently 144 states parties to CITES.

<sup>121</sup>We note that all of the participants in this appeal are parties to CITES.

conservation of natural resources for the purposes of Article XX(g). There, we answered in the affirmative the question posed before the panel of whether the baseline establishment rules were "primarily aimed at" the conservation of clean air.<sup>122</sup> We held that:

... The baseline establishment rules whether individual or statutory, were designed to permit scrutiny and monitoring of the level of compliance of refiners, importers and blenders with the "non-degradation" requirements. Without baselines of some kind, such scrutiny would not be possible and the Gasoline Rule's objective of stabilizing and preventing further deterioration of the level of air pollution prevailing in 1990, would be substantially frustrated. ... We consider that, given that substantial relationship, the baseline establishment rules cannot be regarded as merely incidentally or inadvertently aimed at the conservation of clean air in the United States for the purposes of Article XX(g).<sup>123</sup>

The substantial relationship we found there between the EPA baseline establishment rules and the conservation of clean air in the United States was a close and genuine relationship of ends and means.

137. In the present case, we must examine the relationship between the general structure and design of the measure here at stake, Section 609, and the policy goal it purports to serve, that is, the conservation of sea turtles.

138. Section 609(b)(1) imposes an import ban on shrimp that have been harvested with commercial fishing technology which may adversely affect sea turtles. This provision is designed to influence countries to adopt national regulatory programs requiring the use of TEDs by their shrimp fishermen. In this connection, it is important to note that the general structure and design of Section 609 *cum* implementing guidelines is fairly narrowly focused. There are two basic exemptions from the import ban, both of which relate clearly and directly to the policy goal of conserving sea turtles. First, Section 609, as elaborated in the 1996 Guidelines, excludes from the import ban shrimp harvested "under conditions that do not adversely affect sea turtles". Thus, the measure, by its terms, excludes from the import ban: aquaculture shrimp; shrimp species (such as *pandalid* shrimp) harvested in water areas where sea turtles do not normally occur; and shrimp harvested exclusively by artisanal methods, even from non-certified countries.<sup>124</sup> The harvesting of such shrimp clearly does not affect sea turtles. Second, under Section 609(b)(2), the measure exempts from the import ban shrimp caught in waters subject to the jurisdiction of certified countries.

<sup>122</sup>Adopted 20 May 1996, WT/DS2/AB/R, p. 19.

<sup>123</sup>*Ibid.*

<sup>124</sup>See the 1996 Guidelines, p. 17343.

139. There are two types of certification for countries under Section 609(b)(2). First, under Section 609(b)(2)(C), a country may be certified as having a fishing environment that does not pose a threat of incidental taking of sea turtles in the course of commercial shrimp trawl harvesting. There is no risk, or only a negligible risk, that sea turtles will be harmed by shrimp trawling in such an environment.

140. The second type of certification is provided by Section 609(b)(2)(A) and (B). Under these provisions, as further elaborated in the 1996 Guidelines, a country wishing to export shrimp to the United States is required to adopt a regulatory program that is comparable to that of the United States program and to have a rate of incidental take of sea turtles that is comparable to the average rate of United States' vessels. This is, essentially, a requirement that a country adopt a regulatory program requiring the use of TEDs by commercial shrimp trawling vessels in areas where there is a likelihood of intercepting sea turtles.<sup>125</sup> This requirement is, in our view, directly connected with the policy of conservation of sea turtles. It is undisputed among the participants, and recognized by the experts consulted by the Panel<sup>126</sup>, that the harvesting of shrimp by commercial shrimp trawling vessels with mechanical retrieval devices in waters where shrimp and sea turtles coincide is a significant cause of sea turtle mortality. Moreover, the Panel did "not question ... the fact generally acknowledged by the experts that TEDs, when properly installed and adapted to the local area, would be an effective tool for the preservation of sea turtles."<sup>127</sup>

141. In its general design and structure, therefore, Section 609 is not a simple, blanket prohibition of the importation of shrimp imposed without regard to the consequences (or lack thereof) of the mode of harvesting employed upon the incidental capture and mortality of sea turtles. Focusing on the design of the measure here at stake<sup>128</sup>, it appears to us that Section 609, *cum* implementing guidelines, is not disproportionately wide in its scope and reach in relation to the policy objective of protection and conservation of sea turtle species. The means are, in principle, reasonably related to the ends. The means and ends relationship between Section 609 and the legitimate policy of conserving an exhaustible, and, in fact, endangered species, is observably a close and real one, a relationship that is every bit as substantial as that which we found in *United States - Gasoline* between the EPA baseline establishment rules and the conservation of clean air in the United States.

<sup>125</sup>See the 1996 Guidelines, p. 17343.

<sup>126</sup>For example, Panel Report, paras. 5.91-5.118.

<sup>127</sup>Panel Report, para. 7.60, footnote 674.

<sup>128</sup>We focus on the *application* of the measure below, in Section VI.C of this Report.

142. In our view, therefore, Section 609 is a measure "relating to" the conservation of an exhaustible natural resource within the meaning of Article XX(g) of the GATT 1994.

3. "If Such Measures are Made Effective in conjunction with Restrictions on Domestic Production or Consumption"

143. In *United States – Gasoline*, we held that the above-captioned clause of Article XX(g),

... is appropriately read as a requirement that the measures concerned impose restrictions, not just in respect of imported gasoline but also with respect to domestic gasoline. The clause is a requirement of *even-handedness* in the imposition of restrictions, in the name of conservation, upon the production or consumption of exhaustible natural resources.<sup>129</sup>

In this case, we need to examine whether the restrictions imposed by Section 609 with respect to imported shrimp are also imposed in respect of shrimp caught by United States shrimp trawl vessels.

144. We earlier noted that Section 609, enacted in 1989, addresses the mode of harvesting of imported shrimp only. However, two years earlier, in 1987, the United States issued regulations pursuant to the Endangered Species Act requiring all United States shrimp trawl vessels to use approved TEDs, or to restrict the duration of tow-times, in specified areas where there was significant incidental mortality of sea turtles in shrimp trawls.<sup>130</sup> These regulations became fully effective in 1990 and were later modified. They now require United States shrimp trawlers to use approved TEDs "in areas and at times when there is a likelihood of intercepting sea turtles"<sup>131</sup>, with certain limited exceptions.<sup>132</sup> Penalties for violation of the Endangered Species Act, or the regulations issued thereunder, include civil and criminal sanctions.<sup>133</sup> The United States government currently relies on monetary sanctions and civil penalties for enforcement.<sup>134</sup> The government has the ability to seize

<sup>129</sup>Adopted 20 May 1996, WT/DS2/AB/R, pp. 20-21.

<sup>130</sup>52 Fed. Reg. 24244, 29 June 1987.

<sup>131</sup>See the 1996 Guidelines, p. 17343.

<sup>132</sup>According to the 1996 Guidelines, p. 17343, the exceptions are: vessels equipped exclusively with certain special types of gear; vessels whose nets are retrieved exclusively by manual rather than mechanical means; and, in exceptional circumstances, where the National Marine Fisheries Service determines that the use of TEDs would be impracticable because of special environmental conditions, vessels are permitted to restrict tow-times instead of using TEDs.

<sup>133</sup>Endangered Species Act, Section 11.

<sup>134</sup>Statement by the United States at the oral hearing.

shrimp catch from trawl vessels fishing in United States waters and has done so in cases of egregious violations.<sup>135</sup> We believe that, in principle, Section 609 is an even-handed measure.

145. Accordingly, we hold that Section 609 is a measure made effective in conjunction with the restrictions on domestic harvesting of shrimp, as required by Article XX(g).

C. *The Introductory Clauses of Article XX: Characterizing Section 609 under the Chapeau's Standards*

146. As noted earlier, the United States invokes Article XX(b) only if and to the extent that we hold that Section 609 falls outside the scope of Article XX(g). Having found that Section 609 does come within the terms of Article XX(g), it is not, therefore, necessary to analyze the measure in terms of Article XX(b).

147. Although provisionally justified under Article XX(g), Section 609, if it is ultimately to be justified as an exception under Article XX, must also satisfy the requirements of the introductory clauses -- the "chapeau" -- of Article XX, that is,

Article XX

*General Exceptions*

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 Member of measures: (emphasis added)

We turn, hence, to the task of appraising Section 609, and specifically the manner in which it is applied under the chapeau of Article XX; that is, to the second part of the two-tier analysis required under Article XX.

I. General Considerations

148. We begin by noting one of the principal arguments made by the United States in its appellant's submission. The United States argues:

<sup>135</sup>Statement by the United States at the oral hearing.

In context, an alleged "discrimination between countries where the same conditions prevail" is not "unjustifiable" where the policy goal of the Article XX exception being applied provides a rationale for the justification. If, for example, a measure is adopted for the purpose of conserving an exhaustible natural resource under Article XX(g), it is relevant whether the conservation goal justifies the discrimination. In this way, the Article XX chapeau guards against the misuse of the Article XX exceptions for the purpose of achieving indirect protection.<sup>136</sup>

...

[A]n evaluation of whether a measure constitutes "unjustifiable discrimination [between countries] where the same conditions prevail" should take account of whether differing treatment between countries relates to the policy goal of the applicable Article XX exception. If a measure differentiates between countries based on a rationale legitimately connected with the policy of an Article XX exception, rather than for protectionist reasons, the measure does not amount to an abuse of the applicable Article XX exception.<sup>137</sup> (emphasis added)

149. We believe this argument must be rejected. The policy goal of a measure at issue cannot provide its rationale or justification under the standards of the chapeau of Article XX. The legitimacy of the declared policy objective of the measure, and the relationship of that objective with the measure itself and its general design and structure, are examined under Article XX(g), and the treaty interpreter may then and there declare the measure inconsistent with Article XX(g). If the measure is not held provisionally justified under Article XX(g), it cannot be ultimately justified under the chapeau of Article XX. On the other hand, it does not follow from the fact that a measure falls within the terms of Article XX(g) that that measure also will necessarily comply with the requirements of the chapeau. To accept the argument of the United States would be to disregard the standards established by the chapeau.

150. We commence the second tier of our analysis with an examination of the ordinary meaning of the words of the chapeau. The precise language of the chapeau requires that a measure not be 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." There are three standards contained in the chapeau: first, arbitrary discrimination between countries where the same conditions prevail; second, unjustifiable discrimination between countries where the same conditions prevail; and third, a disguised restriction on international trade. In order for a measure to

<sup>136</sup>United States appellant's submission, para. 28.

<sup>137</sup>United States appellant's submission, para. 53.

be applied in a manner which would constitute "arbitrary or unjustifiable discrimination between countries where the same conditions prevail", three elements must exist. First, the application of the measure must result in *discrimination*. As we stated in *United States – Gasoline*, the nature and quality of this discrimination is different from the discrimination in the treatment of products which was already found to be inconsistent with one of the substantive obligations of the GATT 1994, such as Articles I, III or XI.<sup>138</sup> Second, the discrimination must be *arbitrary or unjustifiable* in character. We will examine this element of *arbitrariness* or *unjustifiability* in detail below. Third, this discrimination must occur *between countries where the same conditions prevail*. In *United States – Gasoline*, we accepted the assumption of the participants in that appeal that such discrimination could occur not only between different exporting Members, but also between exporting Members and the importing Member concerned.<sup>139</sup> Thus, the standards embodied in the language of the chapeau are not only different from the requirements of Article XX(g); they are also different from the standard used in determining that Section 609 is violative of the substantive rules of Article XI:1 of the GATT 1994.

151. In *United States – Gasoline*, we stated that "the purpose and object of the introductory clauses of Article XX is generally the prevention of 'abuse of the exceptions of [Article XX]'.<sup>140</sup> We went on to say that:

... The chapeau is animated by the principle that while the exceptions of Article XX may be invoked as a matter of legal right, they should not be so applied as to frustrate or defeat the legal obligations of the holder of the right under the substantive rules of the *General Agreement*. If those exceptions are not to be abused or misused, in other words, the measures falling within the particular exceptions must be applied reasonably, with due regard both to the legal duties of the party claiming the exception and the legal rights of the other parties concerned.<sup>141</sup>

152. At the end of the Uruguay Round, negotiators fashioned an appropriate preamble for the new *WTO Agreement*, which strengthened the multilateral trading system by establishing an international organization, *inter alia*, to facilitate the implementation, administration and operation, and to further the objectives, of that Agreement and the other agreements resulting from that Round.<sup>142</sup> In

<sup>138</sup>In *United States – Gasoline*, adopted 20 May 1996, WT/DS2/AB/R, p. 23, we stated: "The provisions of the chapeau cannot logically refer to the same standard(s) by which a violation of a substantive rule has been determined to have occurred."

<sup>139</sup>*Ibid.*, pp. 23-24.

<sup>140</sup>*Ibid.*, p. 22.

<sup>141</sup>*Ibid.*

<sup>142</sup>*WTO Agreement*, Article III:1.

recognition of the importance of continuity with the previous GATT system, negotiators used the preamble of the GATT 1947 as the template for the preamble of the new *WTO Agreement*. Those negotiators evidently believed, however, that the objective of "full use of the resources of the world" set forth in the preamble of the GATT 1947 was no longer appropriate to the world trading system of the 1990's. As a result, they decided to qualify the original objectives of the GATT 1947 with the following words:

... while allowing for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development, ...<sup>143</sup>

153. We note once more<sup>144</sup> that this language demonstrates a recognition by WTO negotiators that optimal use of the world's resources should be made in accordance with the objective of sustainable development. As this preambular language reflects the intentions of negotiators of the *WTO Agreement*, we believe it must add colour, texture and shading to our interpretation of the agreements annexed to the *WTO Agreement*, in this case, the GATT 1994. We have already observed that Article XX(g) of the GATT 1994 is appropriately read with the perspective embodied in the above preamble.<sup>145</sup>

154. We also note that since this preambular language was negotiated, certain other developments have occurred which help to elucidate the objectives of WTO Members with respect to the relationship between trade and the environment. The most significant, in our view, was the Decision of Ministers at Marrakesh to establish a permanent Committee on Trade and Environment (the "CTE"). In their Decision on Trade and Environment, Ministers expressed their intentions, in part, as follows:

... *Considering* that there should not be, nor need be, any policy contradiction between upholding and safeguarding an open, non-discriminatory and equitable multilateral trading system on the one hand, and acting for the protection of the environment, and the promotion of sustainable development on the other, ...<sup>146</sup>

<sup>143</sup>Preamble of the *WTO Agreement*, first paragraph.

<sup>144</sup>*Supra*, para. 129.

<sup>145</sup>*Supra*, para. 131.

<sup>146</sup>Preamble of the Decision on Trade and Environment.

In this Decision, Ministers took "note" of the Rio Declaration on Environment and Development<sup>147</sup>, Agenda 21<sup>148</sup>, and "its follow-up in the GATT, as reflected in the statement of the Council of Representatives to the CONTRACTING PARTIES at their 48th Session in 1992 ..."<sup>149</sup> We further note that this Decision also set out the following terms of reference for the CTE:

- (a) to identify the relationship between trade measures and environmental measures, in order to promote sustainable development;
- (b) to make appropriate recommendations on whether any modifications of the provisions of the multilateral trading system are required, compatible with the open, equitable and non-discriminatory nature of the system, as regards, in particular:
  - the need for rules to enhance positive interaction between trade and environmental measures, for the promotion of sustainable development, with special consideration to the needs of developing countries, in particular those of the least developed among them; and
  - the avoidance of protectionist trade measures, and the adherence to effective multilateral disciplines to ensure responsiveness of the multilateral trading system to environmental objectives set forth in Agenda 21 and the Rio Declaration, in particular Principle 12; and
  - surveillance of trade measures used for environmental purposes, of trade-related aspects of environmental measures which have significant trade effects, and of effective implementation of the multilateral disciplines governing those measures.<sup>150</sup>

155. With these instructions, the General Council of the WTO established the CTE in 1995, and the CTE began its important work. Pending any specific recommendations by the CTE to WTO Members on the issues raised in its terms of reference, and in the absence up to now of any agreed amendments or modifications to the substantive provisions of the GATT 1994 and the *WTO Agreement* generally, we must fulfill our responsibility in this specific case, which is to interpret

<sup>147</sup>We note that Principle 3 of the Rio Declaration on Environment and Development states: "The right to development must be fulfilled so as to equitably meet developmental and environmental needs of present and future generations." Principle 4 of the Rio Declaration on Environment and Development states that: "In order to achieve sustainable development, environmental protection shall constitute an integral part of the development process and cannot be considered in isolation from it."

<sup>148</sup>Agenda 21 is replete with references to the shared view that economic development and the preservation and protection should be mutually supportive. For example, paragraph 2.3(b) of Agenda 21 states: "The international economy should provide a supportive international climate for achieving environment and development goals by ... [m]aking trade and environment mutually supportive ...". Similarly, paragraph 2.9(d) states that an "objective" of governments should be: "To promote and support policies, domestic and international, that make economic growth and environmental protection mutually supportive."

<sup>149</sup>Preamble of the Decision on Trade and Environment.

<sup>150</sup>Decision on Trade and Environment.

the existing language of the chapeau of Article XX by examining its ordinary meaning, in light of its context and object and purpose in order to determine whether the United States measure at issue qualifies for justification under Article XX. It is proper for us to take into account, as part of the context of the chapeau, the specific language of the preamble to the *WTO Agreement*, which, as we have said, gives colour, texture and shading to the rights and obligations of Members under the *WTO Agreement*, generally, and under the GATT 1994, in particular.

156. Turning then to the chapeau of Article XX, we consider that it embodies the recognition on the part of WTO Members of the need to maintain a balance of rights and obligations between the right of a Member to invoke one or another of the exceptions of Article XX, specified in paragraphs (a) to (j), on the one hand, and the substantive rights of the other Members under the GATT 1994, on the other hand. Exercise by one Member of its right to invoke an exception, such as Article XX(g), if abused or misused, will, to that extent, erode or render naught the substantive treaty rights in, for example, Article XI:1, of other Members. Similarly, because the GATT 1994 itself makes available the exceptions of Article XX, in recognition of the legitimate nature of the policies and interests there embodied, the right to invoke one of those exceptions is not to be rendered illusory. The same concept may be expressed from a slightly different angle of vision, thus, a balance must be struck between the *right* of a Member to invoke an exception under Article XX and the *duty* of that same Member to respect the treaty rights of the other Members. To permit one Member to abuse or misuse its right to invoke an exception would be effectively to allow that Member to degrade its own treaty obligations as well as to devalue the treaty rights of other Members. If the abuse or misuse is sufficiently grave or extensive, the Member, in effect, reduces its treaty obligation to a merely facultative one and dissolves its juridical character, and, in so doing, negates altogether the treaty rights of other Members. The chapeau was installed at the head of the list of "General Exceptions" in Article XX to prevent such far-reaching consequences.

157. In our view, the language of the chapeau makes clear that each of the exceptions in paragraphs (a) to (j) of Article XX is a *limited and conditional* exception from the substantive obligations contained in the other provisions of the GATT 1994, that is to say, the ultimate availability of the exception is subject to the compliance by the invoking Member with the requirements of the chapeau.<sup>151</sup> This interpretation of the chapeau is confirmed by its negotiating

<sup>151</sup>This view is consistent with the approach taken by the panel in *United States – Section 337 of the United States Tariff Act of 1930*, which stated:  
Article XX is entitled "General Exceptions" and ... the central phrase in the introductory clause reads: "nothing in this Agreement shall be construed to prevent the adoption or enforcement ... of measures..." Article XX(d) thus provides a *limited and conditional exception from obligations under other provisions*.<sup>151</sup> (emphasis added) Adopted 7 November 1989, BISD 365/345, para. 5.9.

history.<sup>152</sup> The language initially proposed by the United States in 1946 for the chapeau of what would later become Article XX was unqualified and unconditional.<sup>153</sup> Several proposals were made during the First Session of the Preparatory Committee of the United Nations Conference on Trade and Employment in 1946 suggesting modifications.<sup>154</sup> In November 1946, the United Kingdom proposed that "in order to prevent abuse of the exceptions of Article 32 [which would subsequently become Article XX]", the chapeau of this provision should be qualified.<sup>155</sup> This proposal was generally accepted, subject to later review of its precise wording. Thus, the negotiating history of Article XX confirms that the paragraphs of Article XX set forth *limited and conditional* exceptions from the obligations of the substantive provisions of the GATT. Any measure, to qualify finally for exception, must also satisfy the requirements of the chapeau. This is a fundamental part of the balance of rights and obligations struck by the original framers of the GATT 1947.

158. The chapeau of Article XX is, in fact, but one expression of the principle of good faith. This principle, at once a general principle of law and a general principle of international law, controls the exercise of rights by states. One application of this general principle, the application widely known as the doctrine of *abus de droit*, prohibits the abusive exercise of a state's rights and enjoins that whenever the assertion of a right "impinges on the field covered by [a] treaty obligation, it must be

<sup>152</sup>Article 32 of the Vienna Convention permits recourse to "supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when interpretation according to article 31: (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable." Here, we refer to the negotiating history of Article XX to confirm the interpretation of the chapeau we have reached from applying Article 31 of the Vienna Convention.

<sup>153</sup>The chapeau of Article 32 of the United States Draft Charter for an International Trade Organization, which formed the basis for discussions at the First Session of the Preparatory Committee of the United Nations Conference on Trade and Employment in late 1946, read, in relevant part:

Nothing in Chapter IV of this Charter shall be construed to prevent the adoption or enforcement by any member of measures: ...

<sup>154</sup>For example, the Netherlands, Belgium and Luxembourg stated that the exceptions should be qualified in some way:

Indirect protection is an undesirable and dangerous phenomenon ... Many times, the stipulations to 'protect animal or plant life or health' are misused for indirect protection. It is recommended to insert a clause which prohibits expressly to direct such measures that they constitute an indirect protection or, in general, to use these measures to attain results, which are irreconcilable [*sic*] with the aim of chapters IV, V and VI. E/PC/T/C.II/32, 30 October 1946

<sup>155</sup>The United Kingdom's proposed text for the chapeau read:

The undertaking in Chapter IV of this Charter relating to import and export restrictions shall not be construed to prevent the adoption or enforcement by any member of measures for the following purposes, provided that they are not applied in such a manner as to constitute a means of arbitrary discrimination between countries where the same conditions prevail, or a disguised restriction on international trade. E/PC/T/C.II/50, pp. 7 and 9; E/PC/T/C.II/54/Rev.1, 28 November 1946, p. 36.

exercised bona fide, that is to say, reasonably."<sup>156</sup> An abusive exercise by a Member of its own treaty right thus results in a breach of the treaty rights of the other Members and, as well, a violation of the treaty obligation of the Member so acting. Having said this, our task here is to interpret the language of the chapeau, seeking additional interpretative guidance, as appropriate, from the general principles of international law.<sup>157</sup>

159. The task of interpreting and applying the chapeau is, hence, essentially the delicate one of locating and marking out a line of equilibrium between the right of a Member to invoke an exception under Article XX and the rights of the other Members under varying substantive provisions (e.g., Article XI) of the GATT 1994, so that neither of the competing rights will cancel out the other and thereby distort and nullify or impair the balance of rights and obligations constructed by the Members themselves in that Agreement. The location of the line of equilibrium, as expressed in the chapeau, is not fixed and unchanging: the line moves as the kind and the shape of the measures at stake vary and as the facts making up specific cases differ.

160. With these general considerations in mind, we address now the issue of whether the application of the United States measure, although the measure itself falls within the terms of Article XX(g), nevertheless constitutes "a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail" or "a disguised restriction on international trade". We address, in other words, whether the application of this measure constitutes an abuse or misuse of the provisional justification made available by Article XX(g). We note, preliminarily, that the application of a measure may be characterized as amounting to an abuse or misuse of an exception of Article XX not only when the detailed operating provisions of the measure prescribe the arbitrary or unjustifiable activity, but also where a measure, otherwise fair and just on its face, is actually applied in an

<sup>156</sup>B. Cheng, *General Principles of Law as applied by International Courts and Tribunals* (Stevens and Sons, Ltd., 1953), Chapter 4, in particular, p. 125 elaborates:

... A reasonable and bona fide exercise of a right in such a case is one which is appropriate and necessary for the purpose of the right (*i.e.*, in furtherance of the interests which the right is intended to protect). It should at the same time be *fair and equitable as between the parties* and not one which is calculated to procure for one of them an unfair advantage in the light of the obligation assumed. A reasonable exercise of the right is regarded as compatible with the obligation. But the exercise of the right in such a manner as to prejudice the interests of the other contracting party arising out of the treaty is unreasonable and is considered as inconsistent with the bona fide execution of the treaty obligation, and a breach of the treaty. ... (emphasis added)

Also see, for example, Jennings and Watts (eds.), *Oppenheim's International Law*, 9th ed., Vol. I (Longman's, 1992), pp. 407-410, *Border and Transborder Armed Actions Case*, (1988) I.C.J. Rep. 105; *Rights of Nationals of the United States in Morocco Case*, (1952) I.C.J. Rep. 176; *Anglo-Norwegian Fisheries Case*, (1951) I.C.J. Rep. 142.

<sup>157</sup>Venna Convention, Article 31(3)(c).

arbitrary or unjustifiable manner. The standards of the chapeau, in our view, project both substantive and procedural requirements.

2. "Unjustifiable Discrimination"

161. We scrutinize first whether Section 609 has been applied in a manner constituting "unjustifiable discrimination between countries where the same conditions prevail". Perhaps the most conspicuous flaw in this measure's application relates to its intended and actual coercive effect on the specific policy decisions made by foreign governments, Members of the WTO. Section 609, in its application, is, in effect, an economic embargo which requires *all other exporting Members*, if they wish to exercise their GATT rights, to adopt *essentially the same* policy (together with an approved enforcement program) as that applied to, and enforced on, United States domestic shrimp trawlers. As enacted by the Congress of the United States, the *statutory* provisions of Section 609(b)(2)(A) and (B) do not, in themselves, *require* that other WTO Members adopt *essentially the same* policies and enforcement practices as the United States. Viewed alone, the statute appears to permit a degree of discretion or flexibility in how the standards for determining comparability might be applied, in practice, to other countries.<sup>158</sup> However, any flexibility that may have been intended by Congress when it enacted the statutory provision has been effectively eliminated in the implementation of that policy through the 1996 Guidelines promulgated by the Department of State and through the practice of the administrators in making certification determinations.

162. According to the 1996 Guidelines, certification "shall be made" under Section 609(b)(2)(A) and (B) if an exporting country's program includes a requirement that all commercial shrimp trawl vessels operating in waters in which there is a likelihood of intercepting sea turtles use, at all times, TEDs comparable in effectiveness to those used in the United States.<sup>159</sup> Under these Guidelines, any exceptions to the requirement of the use of TEDs must be comparable to those of the United States

<sup>158</sup>Pursuant to Section 609(b)(2), a harvesting nation may be certified, and thus exempted from the import ban, if:

- (A) the government of the harvesting nation has provided documentary evidence of the adoption of a program governing the incidental taking of such sea turtles in the course of such harvesting that is comparable to that of the United States; and
- (B) the average rate of that incidental taking by vessels of the harvesting nation is comparable to the average rate of incidental taking of sea turtles by United States vessels in the course of such harvesting...

<sup>159</sup>1996 Guidelines, p. 17344.

program.<sup>160</sup> Furthermore, the harvesting country must have in place a "credible enforcement effort".<sup>161</sup> The language in the 1996 Guidelines is mandatory: certification "shall be made" if these conditions are fulfilled. However, we understand that these rules are also applied in an *exclusive* manner. That is, the 1996 Guidelines specify the *only* way that a harvesting country's regulatory program can be deemed "comparable" to the United States' program, and, therefore, they define the *only* way that a harvesting nation can be certified under Section 609(b)(2)(A) and (B). Although the 1996 Guidelines state that, in making a comparability determination, the Department of State "shall also take into account other measures the harvesting nation undertakes to protect sea turtles"<sup>162</sup>, in practice, the competent government officials only look to see whether there is a regulatory program requiring the use of TEDs or one that comes within one of the extremely limited exceptions available to United States shrimp trawl vessels.<sup>163</sup>

163. The actual *application* of the measure, through the implementation of the 1996 Guidelines and the regulatory practice of administrators, *requires* other WTO Members to adopt a regulatory program that is not merely *comparable*, but rather *essentially the same*, as that applied to the United States shrimp trawl vessels. Thus, the effect of the application of Section 609 is to establish a rigid and unbending standard by which United States officials determine whether or not countries will be certified, thus granting or refusing other countries the right to export shrimp to the United States. Other specific policies and measures that an exporting country may have adopted for the protection and conservation of sea turtles are not taken into account, in practice, by the administrators making the comparability determination.<sup>164</sup>

164. We understand that the United States also applies a uniform standard throughout its territory, regardless of the particular conditions existing in certain parts of the country. The United States requires the use of approved TEDs at all times by domestic, commercial shrimp trawl vessels operating in waters where there is any likelihood that they may interact with sea turtles, regardless of the actual incidence of sea turtles in those waters, the species of those sea turtles, or other differences or disparities that may exist in different parts of the United States. It may be quite acceptable for a

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<sup>160</sup>As already noted, these exceptions are extremely limited and currently include only: vessels equipped exclusively with certain special types of gear; vessels whose nets are retrieved exclusively by manual rather than mechanical means; and, in exceptional circumstances, where the National Marine Fisheries Services determines that the use of TEDs would be impracticable because of special environmental conditions, vessels are permitted to restrict tow-times instead of using TEDs. See the 1996 Guidelines, p. 17343. In the oral hearing, the United States informed us that the exception for restricted tow-times is no longer available.

<sup>161</sup>1996 Guidelines, p. 17344.

<sup>162</sup>*Ibid.*

<sup>163</sup>Statements by the United States at the oral hearing.

<sup>164</sup>Statement by the United States at the oral hearing.

government, in adopting and implementing a domestic policy, to adopt a single standard applicable to all its citizens throughout that country. However, it is not acceptable, in international trade relations, for one WTO Member to use an economic embargo to *require* other Members to adopt essentially the same comprehensive regulatory program, to achieve a certain policy goal, as that in force within that Member's territory, *without* taking into consideration different conditions which may occur in the territories of those other Members.

165. Furthermore, when this dispute was before the Panel and before us, the United States did not permit imports of shrimp harvested by commercial shrimp trawl vessels using TEDs comparable in effectiveness to those required in the United States if those shrimp originated in waters of countries not certified under Section 609. In other words, *shrimp caught using methods identical to those employed in the United States* have been excluded from the United States market solely because they have been caught in waters of *countries that have not been certified by the United States*. The resulting situation is difficult to reconcile with the declared policy objective of protecting and conserving sea turtles. This suggests to us that this measure, in its application, is more concerned with effectively influencing WTO Members to adopt essentially the same comprehensive regulatory regime as that applied by the United States to its domestic shrimp trawlers, even though many of those Members may be differently situated. We believe that discrimination results not only when countries in which the same conditions prevail are differently treated, but also when the application of the measure at issue does not allow for any inquiry into the appropriateness of the regulatory program for the conditions prevailing in those exporting countries.

166. Another aspect of the application of Section 609 that bears heavily in any appraisal of justifiable or unjustifiable discrimination is the failure of the United States to engage the appellees, as well as other Members exporting shrimp to the United States, in serious, across-the-board negotiations with the objective of concluding bilateral or multilateral agreements for the protection and conservation of sea turtles, before enforcing the import prohibition against the shrimp exports of those other Members. The relevant factual finding of the Panel reads:

... However, we have no evidence that the United States actually undertook negotiations on an agreement on sea turtle conservation techniques which would have included the complainants before the imposition of the import ban as a result of the CIT judgement. From the replies of the parties to our question on this subject, in particular that of the United States, we understand that the United States did not propose the negotiation of an agreement to any of the complainants until after the conclusion of negotiations on the Inter-American Convention for the Protection and Conservation of Sea Turtles, in September 1996, i.e. well after the deadline for the imposition of the import ban of 1 May 1996. Even then, it seems that the efforts made merely consisted of an exchange of documents. We therefore conclude that, in spite of the possibility offered by its legislation, the United States did not enter into negotiations before it imposed the import ban. As we consider that the measures sought by the United States were of the type that would normally require international cooperation, we do not find it necessary to examine whether parties entered into negotiations in good faith and whether the United States, absent any result, would have been entitled to adopt unilateral measures.<sup>165</sup> (emphasis added)

167. A *propos* this failure to have prior consistent recourse to diplomacy as an instrument of environmental protection policy, which produces discriminatory impacts on countries exporting shrimp to the United States with which no international agreements are reached or even seriously attempted, a number of points must be made. First, the Congress of the United States expressly recognized the importance of securing international agreements for the protection and conservation of the sea turtle species in enacting this law. Section 609(a) directs the Secretary of State to:

- (1) *initiate negotiations as soon as possible for the development of bilateral or multilateral agreements with other nations for the protection and conservation of such species of sea turtles;*
- (2) *initiate negotiations as soon as possible with all foreign governments which are engaged in, or which have persons or companies engaged in, commercial fishing operations which, as determined by the Secretary of Commerce, may affect adversely such species of sea turtles, for the purpose of entering into bilateral and multilateral treaties with such countries to protect such species of sea turtles;*
- (3) *encourage such other agreements to promote the purposes of this section with other nations for the protection of specific ocean and land regions which are of special significance to the health and stability of such species of sea turtles;*
- (4) *initiate the amendment of any existing international treaty for the protection and conservation of such species of sea turtles to which the United States is a party in order to make such treaty consistent with the purposes and policies of this section;* and

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<sup>165</sup>Panel Report, para. 7.56.

(5) provide to the Congress by not later than one year after the date of enactment of this section: ...

- (C) a full report on:  
(i) the results of his efforts under this section; ...  
(emphasis added)

Apart from the negotiation of the Inter-American Convention for the Protection and Conservation of Sea Turtles<sup>166</sup> (the "Inter-American Convention") which concluded in 1996, the record before the Panel does not indicate any serious, substantial efforts to carry out these express directions of Congress.<sup>167</sup>

168. Second, the protection and conservation of highly migratory species of sea turtles, that is, the very policy objective of the measure, demands concerted and cooperative efforts on the part of the many countries whose waters are traversed in the course of recurrent sea turtle migrations. The need for, and the appropriateness of, such efforts have been recognized in the WTO itself as well as in a significant number of other international instruments and declarations. As stated earlier, the Decision on Trade and Environment, which provided for the establishment of the CTE and set out its terms of reference, refers to both the Rio Declaration on Environment and Development and Agenda 21.<sup>168</sup> Of particular relevance is Principle 12 of the Rio Declaration on Environment and Development, which states, in part:

Unilateral actions to deal with environmental challenges outside the jurisdiction of the importing country should be avoided. *Environmental measures addressing transboundary or global environmental problems should, as far as possible, be based on international consensus.* (emphasis added)

In almost identical language, paragraph 2.22(i) of Agenda 21 provides:

Governments should encourage GATT, UNCTAD and other relevant international and regional economic institutions to examine, in accordance with their respective mandates and competences, the following propositions and principles: ...

- (i) Avoid unilateral action to deal with environmental challenges outside the jurisdiction of the importing country. *Environmental measures addressing transborder problems should, as far as possible, be based on an international consensus.* (emphasis added)

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<sup>166</sup>First written submission of the United States to the Panel, Exhibit AA.

<sup>167</sup>Panel Report, para. 7.56.

<sup>168</sup>See Decision on Trade and Environment, preamble and para. 2(b). See *Supra*, para. 154.

Moreover, we note that Article 5 of the Convention on Biological Diversity states:

... each contracting party shall, as far as possible and as appropriate, cooperate with other contracting parties directly or, where appropriate, through competent international organizations, in respect of areas beyond national jurisdiction and on other matters of mutual interest, for the conservation and sustainable use of biological diversity.

The Convention on the Conservation of Migratory Species of Wild Animals, which classifies the relevant species of sea turtles in its Annex I as "Endangered Migratory Species", states:

The contracting parties [are] convinced that conservation and effective management of migratory species of wild animals requires the concerted action of all States within the national boundaries of which such species spend any part of their life cycle.

Furthermore, we note that WTO Members in the Report of the CTE, forming part of the Report of the General Council to Ministers on the occasion of the Singapore Ministerial Conference, endorsed and supported:

... *multilateral solutions based on international cooperation and consensus as the best and most effective way for governments to tackle environmental problems of a transboundary or global nature.* WTO Agreements and multilateral environmental agreements (MEAs) are representative of efforts of the international community to pursue *shared goals*, and in the development of a mutually supportive relationship between them, *due respect must be afforded to both.*<sup>169</sup> (emphasis added)

169. Third, the United States did negotiate and conclude one regional international agreement for the protection and conservation of sea turtles: The Inter-American Convention. This Convention was opened for signature on 1 December 1996 and has been signed by five countries<sup>170</sup>, in addition to the United States, and four of these countries are currently certified under Section 609.<sup>171</sup> This Convention has not yet been ratified by any of its signatories. The Inter-American Convention provides that each party shall take "appropriate and necessary measures" for the protection,

<sup>169</sup>Report (1996) of the Committee on Trade and Environment, WT/CTE/1, 12 November 1996, para. 171, Section VII of the Report of the General Council to the 1996 Ministerial Conference, WT/MIN(96)/2, 26 November 1996.

<sup>170</sup>Brazil, Costa Rica, Mexico, Nicaragua and Venezuela.

<sup>171</sup>As of 1 January 1998, Brazil was among those countries certified as having adopted programs to reduce the incidental capture of sea turtles in shrimp fisheries comparable to the United States' program. See Panel Report, para. 2.16. However, according to information provided by the United States at the oral hearing, Brazil is not currently certified under Section 609.

conservation and recovery of sea turtle populations and their habitats within such party's land territory and in maritime areas with respect to which it exercises sovereign rights or jurisdiction.<sup>172</sup> Such measures include, notably,

[t]he reduction, to the greatest extent practicable, of the incidental capture, retention, harm or mortality of sea turtles in the course of fishing activities, through the appropriate regulation of such activities, as well as the development, improvement and use of appropriate gear, devices or techniques, including the use of turtle excluder devices (TEDs) pursuant to the provisions of Annex III [of the Convention].<sup>173</sup>

Article XV of the Inter-American Convention also provides, in part:

Article XV  
Trade Measures

1. *In implementing this Convention, the Parties shall act in accordance with the provisions of the Agreement establishing the World Trade Organization (WTO), as adopted at Marrakesh in 1994, including its annexes.*
2. *In particular, and with respect to the subject-matter of this Convention, the Parties shall act in accordance with the provisions of the Agreement on Technical Barriers to Trade contained in Annex I of the WTO Agreement, as well as Article XI of the General Agreement on Tariffs and Trade of 1994....* (emphasis added)

170. The juxtaposition of (a) the *consensual* undertakings to put in place regulations providing for, *inter alia*, use of TEDs *jointly determined* to be suitable for a particular party's maritime areas, with (b) the reaffirmation of the parties' obligations under the *WTO Agreement*, including the *Agreement on Technical Barriers to Trade* and Article XI of the GATT 1994, suggests that the parties to the Inter-American Convention together marked out the equilibrium line to which we referred earlier. The Inter-American Convention demonstrates the conviction of its signatories, including the United States, that consensual and multilateral procedures are available and feasible for the establishment of programs for the conservation of sea turtles. Moreover, the Inter-American Convention emphasizes the continuing validity and significance of Article XI of the GATT 1994, and of the obligations of the *WTO Agreement* generally, in maintaining the balance of rights and obligations under the *WTO Agreement* among the signatories of that Convention.

<sup>172</sup>Inter-American Convention, Article IV.1.

<sup>173</sup>Inter-American Convention, Article IV.2(h).

171. The Inter-American Convention thus provides convincing demonstration that an alternative course of action was reasonably open to the United States for securing the legitimate policy goal of its measure, a course of action other than the unilateral and non-consensual procedures of the import prohibition under Section 609. It is relevant to observe that an import prohibition is, ordinarily, the heaviest "weapon" in a Member's armoury of trade measures. The record does not, however, show that serious efforts were made by the United States to negotiate similar agreements with any other country or group of countries before (and, as far as the record shows, after) Section 609 was enforced on a world-wide basis on 1 May 1996. Finally, the record also does not show that the appellant, the United States, attempted to have recourse to such international mechanisms as exist to achieve cooperative efforts to protect and conserve sea turtles<sup>174</sup> before imposing the import ban.

172. Clearly, the United States negotiated seriously with some, but not with other Members (including the appellees), that export shrimp to the United States. The effect is plainly discriminatory and, in our view, unjustifiable. The unjustifiable nature of this discrimination emerges clearly when we consider the cumulative effects of the failure of the United States to pursue negotiations for establishing consensual means of protection and conservation of the living marine resources here involved, notwithstanding the explicit statutory direction in Section 609 itself to initiate negotiations as soon as possible for the development of bilateral and multilateral agreements.<sup>175</sup> The principal consequence of this failure may be seen in the resulting unilateralism evident in the application of Section 609. As we have emphasized earlier, the policies relating to the necessity for use of particular kinds of TEDs in various maritime areas, and the operating details of these policies, are all shaped by the Department of State, without the participation of the exporting Members. The system and processes of certification are established and administered by the United States agencies alone. The decision-making involved in the grant, denial or withdrawal of certification to the exporting Members, is, accordingly, also unilateral. The unilateral character of the application of Section 609 heightens the disruptive and discriminatory influence of the import prohibition and underscores its unjustifiability.

173. The application of Section 609, through the implementing guidelines together with administrative practice, also resulted in other differential treatment among various countries desiring certification. Under the 1991 and 1993 Guidelines, to be certifiable, fourteen countries in the wider

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<sup>174</sup>While the United States is a party to CITES, it did not make any attempt to raise the issue of sea turtle mortality due to shrimp trawling in the CITES Standing Committee as a subject requiring concerted action by states. In this context, we note that the United States, for example, has not signed the Convention on the Conservation of Migratory Species of Wild Animals or UNCLOS, and has not ratified the Convention on Biological Diversity.

<sup>175</sup>Section 609(a).

Caribbean/western Atlantic region had to commit themselves to require the use of TEDs on all commercial shrimp trawling vessels by 1 May 1994. These fourteen countries had a "phase-in" period of three years during which their respective shrimp trawling sectors could adjust to the requirement of the use of TEDs. With respect to all other countries exporting shrimp to the United States (including the appellees, India, Malaysia, Pakistan and Thailand), on 29 December 1995, the United States Court of International Trade directed the Department of State to apply the import ban on a world-wide basis not later than 1 May 1996.<sup>176</sup> On 19 April 1996, the 1996 Guidelines were issued by the Department of State bringing shrimp harvested in *all* foreign countries within the scope of Section 609, effective 1 May 1996. Thus, all countries that were not among the fourteen in the wider Caribbean/western Atlantic region had only four months to implement the requirement of compulsory use of TEDs. We acknowledge that the greatly differing periods for putting into operation the requirement for use of TEDs resulted from decisions of the Court of International Trade. Even so, this does not relieve the United States of the legal consequences of the discriminatory impact of the decisions of that Court. The United States, like all other Members of the WTO and of the general community of states, bears responsibility for acts of all its departments of government, including its judiciary.<sup>177</sup>

174. The length of the "phase-in" period is not inconsequential for exporting countries desiring certification. That period relates directly to the onerousness of the burdens of complying with the requisites of certification and the practical feasibility of locating and developing alternative export markets for shrimp. The shorter that period, the heavier the burdens of compliance, particularly where an applicant has a large number of trawler vessels, and the greater the difficulties of re-orienting the harvesting country's shrimp exports. The shorter that period, in net effect, the heavier the influence of the import ban. The United States sought to explain the marked difference between "phase-in" periods granted to the fourteen wider Caribbean/western Atlantic countries and those allowed the rest of the shrimp exporting countries. The United States asserted that the longer time-period was justified by the then undeveloped character of TED technology, while the shorter period was later made possible by the improvements in that technology. This explanation is less than persuasive, for it does not address the administrative and financial costs and the difficulties of governments in putting together and enacting the necessary regulatory programs and "credible

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<sup>176</sup>*Earth Island Institute v. Warren Christopher*, 913 F. Supp. 559 (CIT 1995).

<sup>177</sup>See *United States - Gasoline*, adopted 20 May 1996, WT/DS2/AB/R, p. 28. Also see, for example, Jennings and Watts (eds.), *Oppenheim's International Law*, 9th ed., Vol. I (Longman's 1992), p. 545; and I. Brownlie, *Principles of Public International Law*, 4th ed. (Clarendon Press, 1990), p. 450.

enforcement effort", and in implementing the compulsory use of TEDs on hundreds, if not thousands, of shrimp trawl vessels.<sup>178</sup>

175. Differing treatment of different countries desiring certification is also observable in the differences in the levels of effort made by the United States in transferring the required TED technology to specific countries. Far greater efforts to transfer that technology successfully were made to certain exporting countries -- basically the fourteen wider Caribbean/western Atlantic countries cited earlier -- than to other exporting countries, including the appellees.<sup>179</sup> The level of these efforts is probably related to the length of the "phase-in" periods granted -- the longer the "phase-in" period, the higher the possible level of efforts at technology transfer. Because compliance with the requirements of certification realistically assumes successful TED technology transfer, low or merely nominal efforts at achieving that transfer will, in all probability, result in fewer countries being able to satisfy the certification requirements under Section 609, within the very limited "phase-in" periods allowed them.

176. When the foregoing differences in the means of application of Section 609 to various shrimp exporting countries are considered in their cumulative effect, we find, and so hold, that those differences in treatment constitute "unjustifiable discrimination" between exporting countries desiring certification in order to gain access to the United States shrimp market within the meaning of the chapeau of Article XX.

3. "Arbitrary Discrimination"

177. We next consider whether Section 609 has been applied in a manner constituting "arbitrary discrimination between countries where the same conditions prevail". We have already observed that Section 609, in its application, imposes a single, rigid and unbending requirement that countries applying for certification under Section 609(b)(2)(A) and (B) adopt a comprehensive regulatory program that is essentially the same as the United States' program, without inquiring into the appropriateness of that program for the conditions prevailing in the exporting countries.<sup>180</sup> Furthermore, there is little or no flexibility in how officials make the determination for certification

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<sup>178</sup>For example, at the oral hearing, India stated that its "number of mechanized nets is estimated at about 47,000. Most of these are mechanized vessels ..."

<sup>179</sup>Response by the United States to questioning by the Panel; statements by the United States at the oral hearing.

<sup>180</sup>*Supra*, paras. 161-164.

pursuant to these provisions.<sup>181</sup> In our view, this rigidity and inflexibility also constitute "arbitrary discrimination" within the meaning of the chapeau.

178. Moreover, the description of the administration of Section 609 provided by the United States in the course of these proceedings highlights certain problematic aspects of the certification processes applied under Section 609(b). With respect to the first type of certification, under Section 609(b)(2)(A) and (B), the 1996 Guidelines set out certain elements of the procedures for acquiring certification, including the requirement to submit documentary evidence of the regulatory program adopted by the applicant country. This certification process also generally includes a visit by United States officials to the applicant country.<sup>182</sup>

179. With respect to certifications under Section 609(b)(2)(C), the 1996 Guidelines state that the Department of State "shall certify" any harvesting nation under Section 609(b)(2)(C) if it meets the criteria in the 1996 Guidelines "without the need for action on the part of the government of the harvesting nation ...".<sup>183</sup> Nevertheless, the United States informed us that, in all cases where a country has not previously been certified under Section 609, it waits for an application to be made before making a determination on certification.<sup>184</sup> In the case of certifications under Section 609(b)(2)(C), there appear to be certain opportunities for the submission of written evidence, such as scientific documentation, in the course of the certification process.<sup>185</sup>

180. However, with respect to neither type of certification under Section 609(b)(2) is there a transparent, predictable certification process that is followed by the competent United States government officials. The certification processes under Section 609 consist principally of administrative *ex parte* inquiry or verification by staff of the Office of Marine Conservation in the Department of State with staff of the United States National Marine Fisheries Service.<sup>186</sup> With respect to both types of certification, there is no formal opportunity for an applicant country to be heard, or to respond to any arguments that may be made against it, in the course of the certification process before a decision to grant or to deny certification is made. Moreover, no formal written,

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<sup>181</sup>In the oral hearing, the United States stated that "as a policy matter, the United States government believes that all governments should require the use of turtle excluder devices on all shrimp trawler boats that operate in areas where there is a likelihood of intercepting sea turtles" and that "when it comes to shrimp trawling, we know of only one way of effectively protecting sea turtles, and that is through TEDs."

<sup>182</sup>Statement by the United States at the oral hearing.

<sup>183</sup>1996 Guidelines, p. 17343.

<sup>184</sup>Statement by the United States at the oral hearing.

<sup>185</sup>Statement by the United States at the oral hearing.

<sup>186</sup>Statement by the United States at the oral hearing.

reasoned decision, whether of acceptance or rejection, is rendered on applications for either type of certification, whether under Section 609(b)(2)(A) and (B) or under Section 609(b)(2)(C).<sup>187</sup> Countries which are granted certification are included in a list of approved applications published in the Federal Register; however, they are not notified specifically. Countries whose applications are denied<sup>188</sup> also do not receive notice of such denial (other than by omission from the list of approved applications) or of the reasons for the denial.<sup>189</sup> No procedure for review of, or appeal from, a denial of an application is provided.<sup>190</sup>

181. The certification processes followed by the United States thus appear to be singularly informal and casual, and to be conducted in a manner such that these processes could result in the negation of rights of Members. There appears to be no way that exporting Members can be certain whether the terms of Section 609, in particular, the 1996 Guidelines, are being applied in a fair and just manner by the appropriate governmental agencies of the United States. It appears to us that, effectively, exporting Members applying for certification whose applications are rejected are denied basic fairness and due process, and are discriminated against, *vis-à-vis* those Members which are granted certification.

182. The provisions of Article X:3<sup>191</sup> of the GATT 1994 bear upon this matter. In our view, Section 609 falls within the "laws, regulations, judicial decisions and administrative rulings of general application" described in Article X:1. Inasmuch as there are due process requirements generally for measures that are otherwise imposed in compliance with WTO obligations, it is only reasonable that rigorous compliance with the fundamental requirements of due process should be required in the application and administration of a measure which purports to be an exception to the treaty obligations of the Member imposing the measure and which effectively results in a suspension *pro hac vice* of the treaty rights of other Members.

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<sup>187</sup>Statement by the United States at the oral hearing.

<sup>188</sup>We were advised at the oral hearing by the United States that these include: Australia, Pakistan and Tunisia.

<sup>189</sup>Statement by the United States at the oral hearing.

<sup>190</sup>Statement by the United States at the oral hearing.

<sup>191</sup>Article X:3 states, in part:

- (a) Each Member shall administer in a uniform, impartial and reasonable manner all its laws, regulations, decisions and rulings of the kind described in paragraph 1 of this Article.
- (b) Each Member shall maintain, or institute as soon as practicable, judicial, arbitral or administrative tribunals or procedures for the purpose, inter alia, of the prompt review and correction of administrative action relating to customs matters

183. It is also clear to us that Article X:3 of the GATT 1994 establishes certain minimum standards for transparency and procedural fairness in the administration of trade regulations which, in our view, are not met here. The non-transparent and *ex parte* nature of the internal governmental procedures applied by the competent officials in the Office of Marine Conservation, the Department of State, and the United States National Marine Fisheries Service throughout the certification processes under Section 609, as well as the fact that countries whose applications are denied do not receive formal notice of such denial, nor of the reasons for the denial, and the fact, too, that there is no formal legal procedure for review of, or appeal from, a denial of an application, are all contrary to the spirit, if not the letter, of Article X:3 of the GATT 1994.

184. We find, accordingly, that the United States measure is applied in a manner which amounts to a means not just of "unjustifiable discrimination", but also of "arbitrary discrimination" between countries where the same conditions prevail, contrary to the requirements of the chapeau of Article XX. The measure, therefore, is not entitled to the justifying protection of Article XX of the GATT 1994. Having made this finding, it is not necessary for us to examine also whether the United States measure is applied in a manner that constitutes a "disguised restriction on international trade" under the chapeau of Article XX.

185. In reaching these conclusions, we wish to underscore what we have *not* decided in this appeal. We have *not* decided that the protection and preservation of the environment is of no significance to the Members of the WTO. Clearly, it is. We have *not* decided that the sovereign nations that are Members of the WTO cannot adopt effective measures to protect endangered species, such as sea turtles. Clearly, they can and should. And we have *not* decided that sovereign states should not act together bilaterally, plurilaterally or multilaterally, either within the WTO or in other international fora, to protect endangered species or to otherwise protect the environment. Clearly, they should and do.

186. What we *have* decided in this appeal is simply this: although the measure of the United States in dispute in this appeal serves an environmental objective that is recognized as legitimate under paragraph (g) of Article XX of the GATT 1994, this measure has been applied by the United States in a manner which constitutes arbitrary and unjustifiable discrimination between Members of the WTO, contrary to the requirements of the chapeau of Article XX. For all of the specific reasons outlined in this Report, this measure does not qualify for the exemption that Article XX of the GATT 1994 affords to measures which serve certain recognized, legitimate environmental purposes but which, at the same time, are not applied in a manner that constitutes a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on

international trade. As we emphasized in *United States – Gasoline*, WTO Members are free to adopt their own policies aimed at protecting the environment as long as, in so doing, they fulfill their obligations and respect the rights of other Members under the *WTO Agreement*.<sup>192</sup>

Signed in the original at Geneva this 8th day of October 1998 by:

## VII. Findings and Conclusions

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

- (a) reverses the Panel's finding that accepting non-requested information from non-governmental sources is incompatible with the provisions of the DSU;
- (b) reverses the Panel's finding that the United States measure at issue is not within the scope of measures permitted under the chapeau of Article XX of the GATT 1994, and
- (c) concludes that the United States measure, while qualifying for provisional justification under Article XX(g), fails to meet the requirements of the chapeau of Article XX, and, therefore, is not justified under Article XX of the GATT 1994.

188. The Appellate Body *recommends* that the DSB request the United States to bring its measure found in the Panel Report to be inconsistent with Article XI of the GATT 1994, and found in this Report to be not justified under Article XX of the GATT 1994, into conformity with the obligations of the United States under that Agreement.

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<sup>192</sup>A.adopted 20 May 1996, WT/DS2/AB/R, p. 30.



**World Trade Organization**

**Korea – Measures affecting Imports of Fresh, Chilled and  
Frozen Beef**

**Report of the Appellate Body, 11 December 2000**

# WORLD TRADE ORGANIZATION

WT/DS161/AB/R  
WT/DS169/AB/R  
11 December 2000  
(00-5347)

Original: English

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## KOREA – MEASURES AFFECTING IMPORTS OF FRESH, CHILLED AND FROZEN BEEF

AB-2000-8

*Report of the Appellate Body*

WORLD TRADE ORGANIZATION  
APPELLATE BODY

**Korea – Measures Affecting Imports of  
Fresh, Chilled and Frozen Beef**

AB-2000-8

Present:

Ehlermann, Presiding Member  
Abi-Saab, Member  
Feliciano, Member

Canada, *Third Participant*  
New Zealand, *Third Participant*

Korea, *Appellant*  
Australia, *Appellee*  
United States, *Appellee*

**I. Introduction**

1. Korea appeals certain issues of law and legal interpretations in the Panel Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef* (the "Panel Report").<sup>1</sup> The Panel was established to consider a complaint by Australia and the United States with respect to Korean measures that affect the importation of certain beef products. The aspects of these measures relevant for this appeal relate to, first, domestic support provided to the beef industry and to the Korean agriculture sector more generally, and, second, the separate retail distribution channels that exist for certain imported and domestic beef products (the so-called "dual retail system") and related measures. The dual retail system is given legal effect by the *Management Guideline for Imported Beef* (the "Management Guideline").<sup>2</sup> The factual aspects of this dispute are described in detail in paragraphs 8 through 29 of the Panel Report.

2. The Panel considered claims by Australia that the requirements imposed on the retail sale of imported beef are contrary to Articles III and XI of the *General Agreement on Tariffs and Trade 1994* (the "GATT 1994"); that the tendering process adopted by the Livestock Products

Marketing Organization (the "LPMO") results in quantitative restrictions being applied to grass-fed beef, contrary to Articles II:1, III:4, XI:1 and XVII of the GATT 1994; that discharge procedures for LPMO beef are contrary to Articles III, XI and XVII of the GATT 1994 and Article 4.2 of the *Agreement on Agriculture*; that restrictions on sales of beef imported by the LPMO are contrary to Article III:4 of the GATT 1994; that Korea applies a mark-up on beef imported under the "Simultaneous Buy/Sell" ("SBS") system which is inconsistent with Korea's obligations under Articles II or III of the GATT 1994; that the SBS system applies limitations on the import and distribution of imported beef, and imposes labelling, reporting and record-keeping requirements, that are contrary to Articles III and XI of the GATT 1994; and that, in 1997, Korea provided domestic support to its beef industry which resulted in Korea's Current Total Aggregate Measurement of Support ("AMS") for 1997 being in excess of its reduction commitments for that year, contrary to Articles 3, 6 and 7 of the *Agreement on Agriculture*.<sup>3</sup>

3. The Panel also considered claims by the United States that Korea's requirement that imported beef be sold only in specialized imported beef stores, and its laws and regulations restricting the resale and distribution of imported beef by SBS super-groups, retailers, customers, and end-users are inconsistent with its obligations under Article III:4 of the GATT 1994; that Korea's discretionary import regime, as well as the LPMO's establishment of minimum import prices and delay of both invitations to tender as well as quota allocations, are inconsistent with its obligations under Article XI:1 of the GATT 1994, Article 4.2 of the *Agreement on Agriculture*, and Articles 1 and 3 of the *Agreement on Import Licensing Procedures*; that Korea's imposition of other duties or charges in the form of a mark-up not provided for in Korea's Schedule LX is inconsistent with its obligations under Article II:1 of the GATT 1994; and that Korea has failed to fulfill its reduction commitment for domestic support for 1997 and 1998, and has, thus, acted inconsistently with its obligations under Articles 3, 6, and 7 of the *Agreement on Agriculture*.<sup>4</sup>

4. The Panel Report was circulated to the Members of the World Trade Organization (the "WTO") on 31 July 2000.

5. The Panel concluded that certain of the measures at issue are included in "the remaining restrictions" within the meaning of Note 6(c) of Korea's Schedule and thus benefit from a transitional period until 1 January 2001, by which date they shall be eliminated or otherwise brought into conformity with the *Marrakesh Agreement Establishing the World Trade Organization* (the "WTO Agreement"); that the dual retail system for beef (including the obligation for department

<sup>3</sup>Panel Report, para. 49.

<sup>4</sup>*Ibid.*, para. 51.

<sup>1</sup>WT/DS161/R, WT/DS169/R, 31 July 2000.

<sup>2</sup>The essential features of the Korean dual retail system for beef are found in the *Guidelines Concerning Registration and Operation of Specialized Imported Beef Stores*, (61550-81) 29 January 1990, modified on 15 March 1994; and the *Regulations Concerning Sales of Imported Beef*, (51550-100), modified on 27 March 1993, 7 April 1994, and 29 June 1998. On 1 October 1999, these two instruments were replaced by the *Management Guideline for Imported Beef*, (Ministry of Agriculture Notice 1999-67), which maintained, however, the basic principles of the dual retail system. The *Management Guideline* is an elaboration of Article 25 of the *Livestock Act (Revised)*, as amended by Act No. 5720 on 29 January 1999.

stores and supermarkets authorized to sell imported beef to hold a separate display, and the obligation for foreign beef shops to bear a sign with the words "Specialized Imported Beef Store") is inconsistent with the provisions of Article III:4 of the GATT 1994 in that it treats imported beef less favourably than domestic beef, and cannot be justified pursuant to Article XX(d) of the GATT 1994; that the requirement that the supply of beef from the LPMO's wholesale market be limited to specialized imported beef stores is inconsistent with Article III:4 of the GATT 1994 and cannot be justified pursuant to Article XX(d) of the GATT 1994; that the imposition of more stringent record-keeping requirements on those who purchase foreign beef imported by the LPMO than on those who purchase domestic beef is inconsistent with Article III:4 of the GATT 1994; that the prohibition against cross-trading between end-users of the SBS system is inconsistent with Article III:4 of the GATT 1994; that any additional labelling requirements imposed on foreign beef imported through the SBS system that are not also imposed on domestic beef, such as the requirement that the end-consumer, the contract number and super-group importer be identified and indicated on the imported beef, are inconsistent with Article III:4 of the GATT 1994; that the LPMO's lack of, and delays in, calling for tenders, and its discharge practices between November 1997 and the end of May 1998, constitute import restrictions on foreign beef, inconsistent with Article XI of the GATT 1994, and the same practices are also inconsistent with Article 4.2 of the *Agreement on Agriculture* and its footnote; that even if the LPMO had not had monopoly rights over the import and distribution of its share of Korea's beef import, the LPMO's lack of, and delays in, calling for tenders during the same period constituted an import restriction inconsistent with Article XI of the GATT 1994 through the application of the Ad Note to Articles XI, XII, XIII, XIV and XVIII of the GATT 1994, and that the LPMO's discharge practices during the same period were inconsistent with Article XVII:1(a) of the GATT 1994; that the LPMO's calls for tenders that are made subject to grass-fed or grain-fed distinctions impose import restrictions inconsistent with Article XI of the GATT 1994, and treat imports of grass-fed beef less favourably than is provided for in Korea's Schedule, contrary to Article II:1(a) of the GATT 1994; that Korea's domestic support for beef for 1997 and 1998 was not correctly calculated and exceeded the *de minimis* level, contrary to Article 6 of the *Agreement on Agriculture*, and was not included in Korea's Current Total AMS, contrary to Article 7.2(a) of the *Agreement on Agriculture*; that Korea's total domestic support (Current Total AMS) for 1997 and 1998 exceeded Korea's commitment levels, as specified in Part IV, Section I of its Schedule, contrary to Article 3.2 of the *Agreement on Agriculture*.<sup>5</sup>

<sup>5</sup>Panel Report, para. 845.

6. The Panel recommended that the Dispute Settlement Body ("DSB") request Korea to bring its measures into conformity with its obligations under the *WTO Agreement*.<sup>6</sup>

7. On 11 September 2000, Korea notified the DSB of its intention to appeal certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel, pursuant to paragraph 4 of Article 16 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), and filed a Notice of Appeal pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "*Working Procedures*"). On 21 September 2000, Korea filed its appellant's submission.<sup>7</sup> On 6 October 2000, Australia and the United States<sup>8</sup> each filed an appellee's submission. On the same day, Canada and New Zealand each filed a third participant's submission.<sup>9</sup>

8. The oral hearing in the appeal was held on 23 and 24 October 2000. The participants and third participants presented oral arguments and responded to questions put to them by the Members of the Division hearing the appeal.

## II. Arguments of the Participants and the Third Participants

### A. Korea – Appellant

#### 1. Terms of Reference

9. Korea claims that the Panel erred by making two findings that were outside its terms of reference. First, the Panel erred by ruling on Part IV, Section I of Korea's Schedule LX, in particular by considering which set of numbers in Schedule LX constitutes Korea's commitment levels. Neither the United States nor Australia challenged Korea's Schedule LX in their requests for the establishment of a panel. As Schedule LX is not mentioned in these panel requests, the complaining parties have not met the "minimum prerequisite" established by the Appellate Body for panel requests under Article 6.2 of the DSU, that treaty provisions claimed to have been violated must be identified, and, therefore, Korea should be considered *per se* to have suffered prejudice.

10. Second, neither the United States nor Australia, in their panel requests, identified Annex 3 of the *Agreement on Agriculture* as a treaty provision claimed to have been violated in the context of

<sup>6</sup>Panel Report, para. 847.

<sup>7</sup>Pursuant to Rule 21(1) of the *Working Procedures*.

<sup>8</sup>Pursuant to Rule 22 of the *Working Procedures*.

<sup>9</sup>Pursuant to Rule 24 of the *Working Procedures*.

Korea's calculation methodology for domestic support to the cattle industry. Consequently, the Panel acted outside its terms of reference when it ruled that Annex 3 provided the basis for calculating Korea's current domestic support for beef. Further, the complaining parties have not met the "minimum prerequisite" established by the Appellate Body for panel requests under Article 6.2 of the DSU.

2. Domestic Support Under the *Agreement on Agriculture*

11. Korea believes the Panel erred in finding that, by virtue of Articles 1(a)(ii) and 1(h)(ii) of the *Agreement on Agriculture*, Korea is bound by the provisions of Annex 3 of that Agreement in its calculation of Current AMS for beef, since it did not have any "constituent data and methodology" for beef in its Schedule. The Panel's interpretation of Articles 1(a)(ii) and 1(h)(ii) leads to an unfair outcome and ignores the object and purpose of the *Agreement on Agriculture*. WTO Members' Schedules on the reduction of subsidies for agricultural products can be understood as multi-year equations. One side of the equation includes the commitment level for a given year, while the other side of the equation includes the actual AMS provided for the same year. Thus, for the equation to be meaningful, both sides of the equation should be based on the same set of data and methodology. Using one methodology for commitment levels and another methodology for actual AMS undermines comparability between the two, and leads to unfair results. All the commitment levels set out in Korea's Schedule and all the actual AMS provided by Korea are calculated on the basis of a consistent methodology, which relies on the base years of 1989-1991 (with an exception for rice) and an "actual purchase" definition of eligible production. However, according to the Panel's ruling, Korea should calculate its Current AMS for beef according to different base years and a different definition of eligible production than was used for calculating commitment levels. Korea argues that this leads to unfair results.

12. Furthermore, Korea contends the Panel's interpretation would frustrate the object and purpose of the *Agreement on Agriculture*, which is, in part, to provide for substantial progressive reduction in agricultural support and protection over an agreed period of time. The Panel's interpretation would make it impossible correctly to determine whether a Member has abided by its reduction commitments or not.

13. Moreover, the Panel's interpretation of Articles 1(a)(ii) and 1(h)(ii) of the *Agreement on Agriculture* would render inutile important parts of these provisions. If the calculation methods of Annex 3 were mandatory, as the Panel suggests, the reference in Articles 1(a)(ii) and 1(h)(ii) to the constituent data and methodology in the tables of supporting material would be reduced to redundancy and inutility. The Panel found that support to Korea's cattle industry should be calculated

solely on the basis of Annex 3, because support to the cattle industry was not included in Korea's Schedule. However, Articles 1(a)(ii) and 1(h)(ii) do not make a distinction between products which are already contained in the Schedule of a Member and those which are not.

14. In addition, in Korea's view, the Panel erred in finding that Korea's annual AMS commitment levels in its Schedule LX were not the figures in brackets, but rather the figures not in brackets. The Panel was fundamentally in error when it found that "Korea did not identify" which of the two sets of figures for annual commitment levels (figures in brackets or figures not in brackets) constitutes Korea's obligation. The Panel failed to apply the general rule of interpretation expressed in Article 31 of the *Vienna Convention on the Law of Treaties*<sup>10</sup> (the "*Vienna Convention*") by not taking into account the context of the terms of Korea's Schedule LX, in particular Note 1 to Korea's Schedule LX, which refers to Note 1 of Supporting Table 6. In addition, the Panel's finding on this point would reduce the figures in brackets, Note 1 to Schedule LX, and Note 1 in Supporting Table 6 to inutility, again contrary to the customary rules of treaty interpretation and previous Appellate Body rulings.

15. Korea also submits that Korea's commitment levels were "public knowledge". Korea's Schedule, including Part IV, Section I, was reviewed by all the negotiating parties during the Uruguay Round. Also, the amount of Korea's subsidy to agricultural products was notified to the Committee on Agriculture every year since 1996. In each notification, Korea used the figures within brackets as Korea's commitment level for the given year. Korea considers that its consistent and amply documented position on this issue has been a matter of public record since 1996 and the very first meeting of the Committee on Agriculture to review Members' notifications under the *Agreement on Agriculture*. Thus, the "subsequent practice" of the parties following the Uruguay Round sustains Korea's position on this point of interpretation. Korea also believes that its position is supported by the manner in which the United States and Australia treated this issue in their first submissions to the Panel.

3. Dual Retail System

(a) Article III:4 of the GATT 1994

16. To Korea, the Panel fundamentally misinterpreted and misapplied Article III:4 of the GATT 1994 when it concluded that the dual retail system maintained by Korea is inconsistent with that provision. Article III:4 requires that WTO Members provide equal conditions of competition to both domestic and foreign like products. Article III:4 is an "obligation of result": the result that must be achieved is "no less favourable treatment for foreign goods". The particular method of achieving

<sup>10</sup>Done at Vienna, 23 May 1969, 1155 U.N.T.S. 331; 8 International Legal Materials 679.

this result is irrelevant. Article III:4 neither imposes nor prohibits any particular means that Members employ to provide equal conditions of competition. According to Korea, its dual retail system does provide "no less favourable treatment to foreign goods", and, therefore, achieves the result required by Article III:4. The Panel erroneously concluded that the dual retail system "constitutes in itself differential treatment."

17. Korea submits that a proper analysis of Korea's obligation under Article III:4 requires review of both *de jure* and *de facto* discrimination. The dual retail system does not amount to either *de jure* or *de facto* discrimination. With regard to *de jure* discrimination, Korea's dual retail system assures perfect regulatory symmetry between imports and domestic products. Imported beef is sold only in stores that choose to sell imported beef, and domestic beef is sold only in stores choosing to sell domestic beef. In addition, there is total freedom on the part of retailers to switch from one category of shops to the other. Thus, the Panel failed to demonstrate that there is any discrimination "demonstrated on the basis of the words of the relevant legislation, regulation or other legal instrument," the standard for a finding of *de jure* discrimination.

18. To demonstrate the presence or absence of *de facto* discrimination, the Panel should have undertaken an analysis of the market as part of an examination of the "total configuration of the facts". Instead, the Panel resorted to "speculation". An examination of the facts of the Korean beef market demonstrates that imported and domestic goods experience equal competitive conditions. The absence of such a factual analysis means that the Panel's finding on the dual retail system under Article III:4 is in error.

19. Korea also argues that the Panel erred in finding the display sign requirement to be inconsistent with Article III:4. The first ground offered by the Panel is that the display sign requirement would necessarily be inconsistent with Article III:4 since the dual retail system had already been found to be inconsistent. However, the Panel itself stated that the display sign requirement is a related measure "which the Panel addresses separately in Section 3 thereafter." In other words, the Panel did not include the display sign requirement in its review of the dual retail system.

20. The second ground cited by the Panel is that the display sign requirement goes beyond the indication of origin of goods. Quoting from a 1956 Working Party Report, the Panel argues that such requirements are inconsistent with Article III:4 of the GATT. To Korea, the legal status of this report is unclear. The language of the report suggests that it was not intended to be binding or to provide an authoritative interpretation of the GATT.

(b) Article XX(d) of the GATT 1994

21. Should the Appellate Body disagree with Korea's claim that the dual retail system is consistent with Article III:4, then Korea submits that the Panel erred in ruling that the dual retail system was not justified under Article XX(d) of the GATT 1994.

22. The Panel found that Korea did not apply a dual retail system for other products in respect of which fraudulent sales have occurred. According to the Panel, such failure was evidence that the dual retail system was not "necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement" under Article XX(d). Korea submits that to decide whether a particular measure is necessary under Article XX(d), panels must simply examine whether another means exists which is less restrictive than the one used, and which can reach the objective sought. Consistency among regulations applicable to different products is irrelevant for establishing whether the means chosen by a WTO Member is necessary to achieve the objective of the regulation.

23. Furthermore, the Panel, in analyzing alternative, less restrictive means, did not take into account the level of enforcement sought. Korea's goal is not simply the "reduction or limitation" of deceptive practices, but their "elimination". The Panel considered four less trade-restrictive alternatives, which are investigations, fines, record-keeping and policing. In view of the fact that all four alternatives already comprise a package of policy tools used by Korea, along with the dual retail system, the Panel should have examined the facts to see whether, if the dual retail system were withdrawn, Korea's regulatory goal of the *elimination* of deceptive practices would be satisfied. Instead, the Panel narrowly focused its review on whether the less restrictive option is reasonably available. The Panel failed to link the means of implementation used to the objective sought.

24. Korea's dual retail system satisfies the requirements of the introductory clause of Article XX of the GATT 1994 as well. As the Appellate Body has held, the introductory clause of Article XX is concerned with the "even-handedness" underlying the application of national legislation. In other words, national legislation must be applied "even-handedly" between and among trading partners. Korea's dual retail system does not differentiate between Korea's trading partners. In fact, the dual retail system imposes, in practice, a much heavier burden on domestic beef producers.

25. Furthermore, in Korea's view, the display sign requirement is justified under Article XX(d) of the GATT 1994 as it is "necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement". To require shop-owners to display a sign that

their store engages in selling imported beef imposes a "proportional burden" in view of the objective sought. Korea considered an alternative measure, but it would not have achieved Korea's objective.

26. Finally, Korea argues that the Panel failed to examine whether the display sign requirement was justified under Article XX(d) of the GATT 1994. The Panel did not explain its failure to examine the display sign requirement under Article XX(d), despite the fact that Korea had made clear that its Article XX defense extended to the display sign requirement as well. Korea submits that, were the Appellate Body to complete the analysis left undone by the Panel, the Appellate Body will find that the display sign requirement is fully justified under Article XX.

B. *Australia – Appellee*

1. Terms of Reference

27. Australia considers that Korea's claim that the Panel ruled outside its terms of reference in making findings as to the commitment levels and the AMS calculation methodology used by Korea to calculate the Current AMS, is unfounded. In Australia's view, the Panel correctly ruled that Australia's panel request meets the requirements of Article 6.2 of the DSU because Australia identified the specific measures at issue and provided a brief summary of the legal basis of the complaint sufficient to present the problem clearly.

28. In respect of the commitment levels, Australia argues that as Articles 3, 6 and 7 of the *Agreement on Agriculture* specifically refer to a Member's Schedule, consideration of Korea's commitment levels contained in Part IV, Section I of Korea's Schedule was within the Panel's terms of reference. A determination as to which of Korea's two sets of commitment levels constituted the figures against which its Current Total AMS should be compared was necessary to the Panel's legal examination of claims under Articles 3, 6 and 7 of the *Agreement on Agriculture*.

29. With regard to the AMS calculation methodology, Australia submits that the Panel took into account the linkages between the obligations contained in Articles 3, 6 and 7 of the *Agreement on Agriculture* and the relevant definitions contained in Article 1 of that Agreement, which include specific reference to methodologies contained in Annex 3. The Panel correctly concluded that it could not assess whether Korea had met its obligations under Articles 3, 6 and 7 without examining the calculation prescriptions for AMS contained in Annex 3.

30. Furthermore, Australia contends that Korea has failed to show any prejudice arising from a deficiency in Australia's request for a panel. Korea appears to have been informed sufficiently well of the claims being made to prepare a defence. Korea seems to have understood the nature of the legal

claims sufficiently well for the purposes of its first submission, in which it argued at length that its calculation methodology was in fact consistent with the *Agreement on Agriculture*. It was not until the final meeting with the Panel that Korea claimed that its ability to defend itself had been prejudiced. Korea has also not shown that third parties were prejudiced.

2. Domestic Support Under the *Agreement on Agriculture*

31. Australia submits that Korea's argument, that the Panel's interpretation of Articles 1(a)(i) and 1(h)(ii) of the *Agreement on Agriculture* is unfair, illogical and results in inappropriate comparisons between a WTO Member's reduction commitments and support provided, is without substance. Korea's arguments evidence a misunderstanding of the concepts of Current AMS, Current Total AMS and Annual and Final Bound Reduction Commitments, as defined in the *Agreement on Agriculture*. Australia states that the two figures involved in the comparison will not necessarily be based on the same product mix, as the categories of products that are subsidized may change from year to year.

32. Australia considers that Korea's interpretation that Current AMS should be calculated based on the constituent data and methodology in Korea's Schedule would render the reference to Annex 3 in Articles 1(a)(i) and 1(h)(ii) inutile. The Panel correctly found that for products where no support was included in the base period, there is no relevant "constituent data or methodology" in the tables of supporting material. Calculations based on Annex 3 are, therefore, mandatory.

33. With regard to the two sets of commitment levels in Korea's Schedule, Australia argues that a treaty interpreter is not required to give effect to treaty terms which are invalid. The Panel noted that Korea is the only WTO Member whose Part IV domestic support Schedule contains two sets of annual commitment levels, and that no provision of the *Agreement on Agriculture* authorizes such a departure from the norm or practice. For this reason, the Panel was under no obligation to give effect to the commitment level figures in brackets.

34. Australia also contends that the question of whether Korea's commitment levels were "public knowledge" is beyond the Appellate Body's mandate under Article 17.6 of the DSU to address "issues of law covered in the panel report and legal interpretations developed by the panel", as Korea did not present any such evidence to the Panel. In any case, public knowledge of a WTO-inconsistent Schedule commitment does not validate that commitment. Finally, Korea did not meet its burden of demonstrating that "subsequent practice" of WTO Members establishes the agreement of Members regarding the interpretation of Korea's Schedule.

3. Dual Retail System

(a) Article III:4 of the GATT 1994

35. In Australia's view, Korea's claim that proper analysis of its obligation under Article III:4 requires a two-step review of whether *de jure* or *de facto* discrimination is at issue is legally flawed and should be rejected. According to Australia, the legal standard imposed by the phrase "less favourable treatment" has long been settled: a panel must consider whether imported products are being accorded effective equality of competitive opportunities.

36. Australia contends that the Panel was correct when it found that the design and architecture of the dual retail system and related measures clearly provide less favourable treatment for imported beef. Australia states that stores selling imported beef face restrictions on volumes, price and types of beef available for sale, additional record-keeping, recording and signage requirements, and the commercial disadvantage of having to dismantle their current business in domestic beef if they wish to test the market for imported beef. Fundamentally, imported beef is prevented from being sold in the same stores, under the same conditions, as domestic beef. Thus, the claim by Korea that "regulatory symmetry" exists cannot be sustained.

37. In Australia's view, the Panel correctly concluded that the dual retail system constitutes, in and of itself, differential treatment. This differential treatment unavoidably results in imported beef being less favourably treated on the Korean market than like domestic products, and the segregation of imported beef provides the domestic product with a competitive advantage over the imported product.

(b) Article XX(d) of the GATT 1994

38. Australia claims the Panel was correct in finding that, even if the dual retail system had been instituted to prevent the fraudulent misrepresentation of imported beef as domestic beef, the measure was not "necessary" to accomplish that purpose, within the meaning of Article XX(d). The Panel explored the alternatives available to Korea, including alternatives currently applied to situations of alleged country of origin fraud involving other foodstuffs where price differentials prevail. This approach reflects the ordinary meaning of the term "necessary" that no reasonable alternative exists, as well as past GATT and WTO practice.

39. Australia submits that the burden is on Korea to demonstrate a *prima facie* case that the dual retail system falls within one of the exceptions of Article XX, and that it meets the requirements of the introductory clause. Korea has to demonstrate that there was no other alternative measure it could

reasonably employ, which was WTO-consistent or less WTO-inconsistent, to secure compliance with the *Unfair Competition Act*. In the particular circumstances of the Korean market for imported beef, where it is otherwise impossible to distinguish between domestic and imported beef, where there is no dual wholesale system and where no record-keeping by stores selling domestic beef is required, it is impossible to conclude that the dual retail system has any serious impact on the prevention or elimination of fraud.

40. Even if the Panel erred in law in finding that the dual retail system did not qualify for the exception provided by Article XX(d), the Appellate Body has sufficient facts and legal argument to complete the Panel's inquiry. In doing so, the Appellate Body should find that the dual retail system does not meet the requirements of the introductory clause of Article XX. Australia considers relevant the fact that Korea only applies the dual retail system to imported beef, despite the fact that the problem of fraud also exists in relation to different types of beef and to a range of other agricultural products where a price differential exists between imported and domestic products. Furthermore, the dual retail system is not an isolated measure in an otherwise non-discriminatory environment for imported beef. Rather, the dual retail system is part of the regulatory framework for imported beef under which the importation, distribution and sale of imported beef is tightly regulated and heavily restricted by the Korean government, and substantial subsidies are provided to domestic producers, consistent with the government's stabilisation policies for domestic beef. Consideration of the dual retail system in this context reveals its protective purpose.

41. According to Australia, Korea is incorrect when it asserts that the Panel did not consider the display sign requirement in its review of the dual retail system. The Panel agreed with Korea that the sign requirement was "essentially ancillary to the dual retail system", and considered the two requirements together under Article XX(d). Thus, the Panel subsumed its findings related to the display sign requirement within its findings related to the dual retail system as a whole.

C. *United States – Appellee*

I. Terms of Reference

42. According to the United States, its panel request clearly states its claim that Korea has increased the level of domestic support for its cattle industry to the point that the total domestic support provided by Korea exceeds its AMS commitment levels. Based on Articles 3, 6 and 7 of the *Agreement on Agriculture*, Korea's current total domestic support is greater than the AMS commitment levels set out in the *Agreement on Agriculture*. All of the pertinent provisions of the *Agreement on Agriculture*, including Annex 3, had to be examined. The determination of the level of

Current Total AMS, requires the application of the provisions of Annex 3, as Annex 3 is "intrinsic" to the calculation of the Current Total AMS.

43. Similarly, the commitment levels in Korea's Schedule also had to be examined. As the Current Total AMS was to be compared to Korea's commitment levels, it was first necessary to determine which set of figures in Korea's Schedule constituted Korea's commitment levels.

44. The United States notes that the Appellate Body has previously stated that a panel is obliged to consider provisions that are "directly linked" to the provisions cited in the panel request. In this case, Annex 3 and the commitment levels in Korea's Schedule are "directly linked" to the claim set out in the panel request, and therefore must be considered.

45. Furthermore, Korea suffered no prejudice on this issue as a result of the complaining parties' panel requests. In fact, Korea, in its first submission, submitted detailed explanations on how it had calculated its AMS for beef. Thus, Korea clearly understood the matter at issue.

## 2. Domestic Support Under the *Agreement on Agriculture*

46. According to the United States, the Panel was correct in its finding that Korea's Current AMS for beef must be calculated in accordance with the requirements of Annex 3 of the *Agreement on Agriculture*. The specific language of Article 1(a)(ii) makes clear that the Current AMS calculation must be made in accordance with the provisions of Annex 3. While additional guidance is provided in this provision, to the effect that the "constituent data and methodology" in Korea's Schedule must be taken into account, this cannot be construed to nullify the express requirement that the Current AMS calculation be performed in accordance with Annex 3.

47. If Korea's Current AMS for beef is calculated correctly, it is more than *de minimis* under Article 6.4 of the *Agreement on Agriculture*, and must therefore be included in the calculations for Current Total AMS. When Current AMS for beef is included in Current Total AMS, Current Total AMS exceeds Korea's AMS commitment levels set out in its Schedule.

48. The United States contends that Korea, by including an alternative set of commitment levels in its Schedule, is trying to modify unilaterally the terms of the *Agreement on Agriculture* to substitute a domestic support commitment that is not in accordance with Annex 3. In effect, by claiming that the figures in brackets represent its commitment levels, Korea is attempting to inflate the amount of its annual AMS commitment level. The methodology used by Korea is not consistent with the obligations under the *Agreement on Agriculture*. The United States notes that a

WTO Member may not, in its Schedule, act inconsistently with its WTO obligations. WTO Members may yield rights and grant benefits in their Schedules, but may not diminish their obligations.

49. Korea has argued that WTO Members knew of the contents of Korea's Schedule, and, therefore, they implicitly accepted the figures in the Schedule. The United States contends that this argument is untenable, for two reasons. First, in making this argument, Korea raises new factual allegations, which may not be addressed by the Appellate Body on appeal. Second, WTO Members did not waive their rights to dispute settlement with regard to other Members' Schedules as a result of the signing of the *WTO Agreement*.

## 3. Dual Retail System

### (a) Article III:4 of the GATT 1994

50. According to the United States, the Panel correctly found that the dual retail system in itself constituted "less favourable treatment" inconsistent with Article III:4. Article III:4 is concerned with preserving the "effective equality of opportunities" for imported products. With regard to the dual retail system, the notion of effective equality of opportunities means that there must be a possibility for imported beef to be physically present with "like" domestic beef at the point of sale to the consumer. By excluding imported beef from the existing retail system for domestic beef, the dual retail system limits the potential market opportunities for imported beef. Since imported beef does not enjoy the same competitive opportunity to be sold in the same manner and in the same stores in which Korean beef is sold, it is treated less favourably than domestic beef.

51. The United States argues that Korea's defense of the dual retail system as providing "regulatory symmetry" between imported and domestic beef must fail. The Panel found that, in fact, the dual retail system, in conjunction with certain restrictions on imports, more onerous record-keeping requirements for imported beef sellers, and the display sign requirement imposed on imported beef sellers, resulted in less favourable treatment for imported beef.

52. Furthermore, the United States contends, the Panel's additional conclusion that the dual retail system involves *de facto* discrimination against imported beef was also correct. The Panel noted the following factors as relevant: the separate store requirement limits the ability of consumers to make side-by-side comparisons of imported and domestic beef and to make purchasing decisions based on differences in quality, characteristics and prices of the respective products; imported beef is segregated due to the obstacles confronted by a store owner who wishes to sell imported beef; and there are fewer imported than domestic beef stores. The Panel found that the segregation of domestic

and imported beef provides domestic beef with a competitive advantage over the imported product. In the view of the United States, this finding of the Panel should be upheld.

53. Article 9 of the *Management Guideline* requires that imported beef stores display a sign indicating that the beef sold in the store is imported. According to the United States, given the undisputed difference in treatment resulting from Article 9 of the Guidelines, Korea bears the burden of demonstrating that the dual retail system does not result in less favourable treatment, and Korea has failed to meet its burden. The Panel's finding that the display sign requirement was "ancillary" to the dual retail system was accurate. The 1956 Working Party Report was simply invoked to "reinforce" the Panel's view, not as a basis for its finding.

(b) Article XX(d) of the GATT 1994

54. The United States argues that the Panel correctly concluded that Korea failed to sustain its burden of justifying its dual retail system under Article XX(d) of the GATT 1994. The Panel determined that in order to benefit from the Article XX(d) exception, Korea had to demonstrate that its dual retail regime: (1) was in place in order to "secure compliance" with laws or regulations that are themselves not inconsistent with the GATT 1994; (2) was "necessary" to secure compliance with those laws or regulations; and (3) was applied in conformity with the requirements of the introductory clause of Article XX. The Panel found that the dual retail system was in place in order to "secure compliance" with laws or regulations that are themselves not inconsistent with the GATT 1994, in particular, the *Unfair Competition Act*. However, the Panel found that Korea did not demonstrate that the dual retail system is "necessary" to secure compliance with Korea's *Unfair Competition Act*.

55. In particular, Korea failed to demonstrate that the WTO-consistent alternatives shown by the complaining parties to be available were inadequate to secure compliance with the *Unfair Competition Act* with regard to imported beef. The Panel found that Korea employed traditional and WTO-consistent means, such as inspections, investigations and prosecutions, to enforce the *Unfair Competition Act* with respect to other imported food products. The Panel regarded this as evidence that Korea could eliminate any fraud involving beef with the same measures.

56. The United States contends that, contrary to Korea's claims, the Panel did not establish a "consistency" standard requiring that uniform measures be used to secure compliance. Rather, the Panel properly examined the enforcement practices used generally by Korea to obtain compliance with the *Unfair Competition Act* to determine whether means other than the dual retail system were

reasonably available. Korea's practice with regard to other products was simply one factor to be taken into account as part of this analysis.

57. In addition, the United States argues that if the Appellate Body finds Korea's dual retail system to be "necessary" in terms of Article XX(d), Korea still cannot benefit from the Article XX exception, as Korea has failed to demonstrate that the dual retail system was designed to "secure compliance" with the *Unfair Competition Act*. The dual retail system does not prevent actions that would be illegal under the provisions of the *Unfair Competition Act* relating to fair trade practices. At most, the dual retail system serves the same objectives as the *Unfair Competition Act*.

58. The United States also submits that the dual retail system does not satisfy the requirements of the introductory clause of Article XX. For reasons of judicial economy, the Panel did not consider this issue. However, if the Appellate Body were to reverse the Panel's finding regarding whether the dual retail system is "necessary" to secure compliance with the *Unfair Competition Act*, the Appellate Body should then complete the legal analysis and find that the dual retail system does not satisfy the requirements of the introductory clause, as that system constitutes "unjustifiable discrimination" within the meaning of the introductory clause.

59. Korea criticizes the Panel for not separately addressing Korea's assertion that the display sign requirement is entitled to an exception under Article XX(d). However, the Panel concluded that the display sign requirement is ancillary to the separate store requirement, and therefore is subject to the same analysis and legal conclusions. Thus, in the view of the United States, the Panel's examination of the dual retail system under Article XX(d) is pertinent to both the separate store requirement and to the display sign requirement.

60. Finally, the United States argues, it was for Korea to demonstrate that the display sign requirement was justified under Article XX(d). However, Korea offered no evidence or reasoning to support a finding that the display sign requirement is independently necessary to secure compliance with the *Unfair Competition Act*.

D. *Arguments of the Third Participants*

1. Canada

(a) Dual Retail System

(i) Article III:4 of the GATT 1994

61. Canada agrees with the Panel's finding that the dual retail system constitutes in itself differential treatment which leads to "less favourable treatment" for imported products under the terms of Article III:4 of the GATT 1994. The dual retail system reduces "direct competition" between imported and domestic beef. In effect, only domestic beef can compete directly against other domestic beef. In these circumstances, imported beef does not benefit from "equal conditions of competition" as compared to domestic beef.

62. Canada supports the Panel's finding that the display sign requirement is "ancillary" to the dual retail system, and thus is also inconsistent with Article III:4 of the GATT 1994. The measure would be inconsistent even if it existed independently of the dual retail system, as it treats imported beef differently than domestic beef, in contravention of Article III:4.

(ii) Article XX(d) of the GATT 1994

63. Canada also agrees with the Panel's finding with regard to Article XX(d).

2. New Zealand

(a) Terms of Reference

64. In New Zealand's view, it is within the Panel's terms of reference to examine the calculation methodology of AMS in order to determine whether Korea's Current Total AMS exceeds its commitment levels, in violation of Articles 3, 6 and 7 of the *Agreement on Agriculture*. Although Annex 3 of the *Agreement on Agriculture* is not specifically referred to in the complaining parties' panel requests in this dispute, Article 6 of the *Agreement on Agriculture*, which is referred to in the panel requests, defines AMS by reference to Article 1. Article 1, in turn, refers to the calculation of AMS in terms of Annex 3. Thus, the provisions of Annex 3 are necessary to determine whether Korea has met its domestic support commitments under Articles 3, 6 and 7.

65. Furthermore, the complaining parties have not made a separate claim regarding Annex 3. Rather, the claim they have made is under Articles 3, 6 and 7 of the *Agreement on Agriculture*, and the references to Annex 3 are simply arguments in support of this claim. Since the claim under

Articles 3, 6 and 7 of the *Agreement on Agriculture* is within the Panel's terms of reference, arguments in support of that claim are within the terms of reference as well.

66. New Zealand also argues that Korea has failed to demonstrate that it has been prejudiced by the omission of a reference to Annex 3 in the panel request. The calculation methods set out in Annex 3 are linked to Articles 3, 6 and 7 of the *Agreement on Agriculture*. New Zealand, as a third party to the dispute, was able to determine the measure and claims at issue and respond accordingly based on the reference in the panel request to "domestic support". Korea has not demonstrated that it could not do the same.

67. Finally, New Zealand contends that Korea failed to bring its procedural objections before the Panel in a timely manner.

(b) Domestic Support Under the *Agreement on Agriculture*

68. New Zealand notes that, according to Article 1(a)(ii) of the *Agreement on Agriculture*, the AMS is to be calculated "in accordance with" Annex 3, but "taking into account" the constituent data and methodology in the supporting tables in a Member's Schedule. Thus, a Member is to calculate the AMS according to Annex 3, but may also use the relevant and applicable constituent data and methodology set out in the supporting tables of its Schedule. However, resort to such data and methodology does not absolve a Member of the obligation of correctly calculating the AMS in a manner consistent with Annex 3.

69. New Zealand further submits that a Member can only take into account the constituent data and methodology where it exists. As there was no data or methodology for beef set out in the supporting tables of Part IV of Korea's Schedule, the Panel was correct to calculate AMS by relying on Annex 3 exclusively.

70. Finally, New Zealand argues that AMS calculations under Annex 3 are based on "eligible" production, as required by that provision. Thus, the argument of Korea that "actual" purchases are properly the basis of its AMS calculation should be rejected.

(c) Dual Retail system

(i) Article III:4 of the GATT 1994

71. New Zealand submits that the term "less favourable treatment" under Article III:4 requires that imported and domestic goods receive "effective equality of opportunities". New Zealand supports the Panel's finding that, in the circumstances of this case, Korea's dual retail system for beef

results in competitive disadvantages for imported beef, as imported beef is denied the opportunity to compete in the framework of an integrated market. As the Panel concluded, the existence of a dual retail system, in circumstances where there is an extensive existing retail system, in itself constitutes a violation of Article III:4.

72. Furthermore, New Zealand agrees with the Panel's finding that the display sign requirement, being ancillary to the dual retail system, is also inconsistent with Article III:4. While the Panel chose to consider this aspect of the dual retail system separately, it is nevertheless one of the components of the dual retail system.

(ii) Article XX(d) of the GATT 1994

73. New Zealand supports the Panel's finding that Korea failed to show that the dual retail system was "necessary" within the meaning of Article XX(d) to accomplish Korea's desired level of fraud prevention. As stated by the Panel, practices used in other sectors to address deceptive practices are relevant for a determination of whether certain practices are "necessary" in the beef sector.

74. New Zealand also contends that the dual retail system is not consistent with the requirements of the introductory clause of Article XX. The dual retail system enables the Korean Government to protect Korea's domestic beef producers from import competition by limiting the terms on which imported products may be sold in the market, and therefore constitutes a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, within the meaning of the introductory clause of Article XX.

### III. Issues Raised in this Appeal

75. The issues raised in this appeal are the following:

- (a) whether examination of Korea's Schedule LX and Annex 3 of the *Agreement on Agriculture* was within the Panel's terms of reference;
- (b) whether the Panel erred in calculating Korea's Current AMS for beef based on Annex 3 of the *Agreement on Agriculture*, and whether the resulting Current Total AMS exceeded Korea's AMS commitment levels for 1997 and 1998;
- (c) whether the "dual retail system", which requires the sale of imported beef in specialized stores, was inconsistent with Article III:4 of the GATT 1994; and

(d) whether the "dual retail system", if inconsistent with Article III:4 of the GATT 1994, can nevertheless be justified under Article XX(d).

### IV. Terms of Reference

76. Before the Panel, Korea argued that its Schedule LX is not mentioned in the complaining parties' panel requests and, therefore, no violation can be claimed with regard to the Schedule.<sup>11</sup> Korea further contended that the panel requests were insufficiently detailed and specific to encompass the complaining parties' claims based on Annex 3 of the *Agreement on Agriculture*.<sup>12</sup>

77. The Panel held that, when examining claims regarding Articles 3, 6 and 7 of the *Agreement on Agriculture*, "its terms of reference require it to examine Korea's Schedule LX to assess whether its domestic support in 1997 and 1998 exceeded the reduction commitments contained in its Schedule"<sup>13</sup>, and that "its assessment of the compatibility of Korea's domestic support with Articles 3, 6 and 7 requires that the Panel compares the effective support provided by Korea as determined using the calculation parameters of Annex 3."<sup>14</sup> Therefore, an examination of Korea's Schedule LX and Annex 3 of the *Agreement on Agriculture* for this purpose was not outside the Panel's terms of reference.

78. On appeal, Korea argues that the Panel erred by ruling on two claims that were outside of its terms of reference. In particular, Korea refers to the Panel's finding as to which set of numbers in its Schedule LX constitutes Korea's levels of commitment<sup>15</sup>; and to the Panel's finding that Korea's methodology for calculating Current Aggregate Measurement of Support ("AMS") for beef was not consistent with the methodology provided in Annex 3 of the *Agreement on Agriculture*.<sup>16</sup>

79. In this dispute, the Panel's terms of reference were defined as follows:

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<sup>11</sup> Panel Report, para. 787.

<sup>12</sup> *Ibid.*

<sup>13</sup> *Ibid.*, para. 803.

<sup>14</sup> *Ibid.*, para. 815.

<sup>15</sup> Korea's appellant's submission, paras. 15-25.

<sup>16</sup> *Ibid.*, paras. 65-70.

To examine, in the light of the relevant provisions of the covered agreements cited by the United States in document WT/DS/161/5 and by Australia in document WT/DS/169/5, the matter referred to the DSB by the United States and Australia in those documents and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements.<sup>17</sup>

Thus, the Panel's terms of reference required it to examine the "matter" referred to the DSB by the complaining parties in the requests for the establishment of a panel by the United States and Australia, respectively.<sup>18</sup> The "matter" referred to the DSB is the set of claims made in these requests.<sup>19</sup>

80. In its panel request, Australia stated, in respect of Korea's agricultural domestic support, that:

Korea has also increased the level of domestic support for its cattle industry in amounts which result in the total domestic support provided by Korea exceeding its Aggregate Measurement of Support (AMS) under the Agreement on Agriculture.

Australia went on to state that Korea was acting inconsistently with obligations under, *inter alia*, Articles 3, 6 and 7 of the *Agreement on Agriculture*.

81. The United States, in its panel request, stated, in very similar terms:

At the same time, Korea has increased the level of domestic support for its cattle industry to the point that the total domestic support provided by Korea exceeds its Aggregate Measurement of Support (AMS) under the Agreement on Agriculture.

The United States also referred to Korea's measures as being inconsistent with, *inter alia*, Articles 3, 6, and 7 of the *Agreement on Agriculture*.

82. Thus, the claim made by both complaining parties was that Korea's domestic support for its cattle industry had increased to the point that Korea exceeded its AMS commitment levels for certain years, in contravention of Articles 3, 6 and 7 of the *Agreement on Agriculture*.

<sup>17</sup>WT/DS161/6, WT/DS169/6; see also Article 7.1 of the DSU.

<sup>18</sup>WT/DS161/5, WT/DS169/5.

<sup>19</sup>See Appellate Body Report, *Brazil – Measures Affecting Desiccated Coconut*, WT/DS22/AB/R, adopted 20 March 1997, p. 22; Appellate Body Report, *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico*, WT/DS60/AB/R, adopted 25 November 1998, para. 72.

83. With respect to Korea's claim that the Panel acted outside its terms of reference in examining the "commitment levels" in Korea's Schedule, the following paragraphs of Articles 3 and 6 of the *Agreement on Agriculture* are of particular importance. Article 3.2 obligates Members not to exceed the support levels they had specified in their Schedules:

Subject to the provisions of Article 6, a Member shall not provide support in favour of domestic producers in excess of the commitment levels specified in Section I of Part IV of its Schedule. (emphasis added)

Article 6.3 in turn states:

A Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule. (emphasis added)

Articles 3.2 and 6.3 both refer explicitly to the "commitment level" specified in Part IV of a Member's Schedule. In order to make a finding on the complaining parties' claim, the Panel had no choice but to determine the appropriate "commitment levels" in Korea's Schedule.

84. With respect to Korea's claim<sup>20</sup> that the Panel acted outside its terms of reference in examining Annex 3 of the *Agreement on Agriculture*, we note that Article 6.4 provides:

(a) A Member shall not be required to include in the calculation of its Current Total AMS and shall not be required to reduce:

(i) product-specific domestic support which would otherwise be required to be included in a Member's calculation of its Current AMS where such support does not exceed 5 per cent of that Member's total value of production of a basic agricultural product during the relevant year;

...

(b) For developing country Members, the *de minimis* percentage under this paragraph shall be 10 per cent.

Article 7.2(a) states:

<sup>20</sup>*Supra*, para. 78.

Any domestic support measure in favour of agricultural producers, including any modification to such measure, and any measure that is subsequently introduced that cannot be shown to satisfy the criteria in Annex 2 to this Agreement or to be exempt from reduction by reason of any other provision of this Agreement shall be included in the Member's calculation of its Current Total AMS.

Both Articles 6 and 7, claimed by the complaining parties to have been violated by Korea, refer explicitly to Current AMS and/or Current Total AMS.

85. AMS and Total AMS are defined in Article 1 of the *Agreement on Agriculture*, entitled "Definition of Terms". According to Article 1(a)

"Aggregate Measurement of Support" and "AMS" mean the annual level of support, expressed in monetary terms, provided for an agricultural product in favour of the producers of the basic agricultural product ... which is:

...

(ii) with respect to support provided during any year of the implementation period and thereafter, *calculated in accordance with the provisions of Annex 3 of this Agreement* and taking into account the constituent data and methodology used in the tables of supporting material incorporated by reference in Part IV of the Member's Schedule; (emphasis added)

According to Article 1(h)

"Total Aggregate Measurement of Support" and "Total AMS" mean the sum of all domestic support provided in favour of agricultural producers, calculated as the sum of all aggregate measurements of support for basic agricultural products, ... which is:

...

(ii) with respect to the level of support actually provided during any year of the implementation period and thereafter (i.e. the "Current Total AMS"), *calculated in accordance with the provisions of this Agreement*, including Article 6, and with the constituent data and methodology used in the tables of supporting material incorporated by reference in Part IV of the Member's Schedule; (emphasis added)

86. While Article 1(h)(ii) uses the terms "provisions of this Agreement", Article 1(a)(ii) is more specific and refers precisely to "*the provisions of Annex 3 of this Agreement*". Annex 3 is entitled "Domestic Support: Calculation of Aggregate Measurement of Support". Through the definitions set

out in Article 1, Annex 3 thus becomes part of Articles 6 and 7. In examining the claims under Articles 3, 6 and 7, the Panel, therefore, had to examine the terms of Annex 3 as well. The Panel had to calculate Current AMS for beef "*in accordance with the provisions of Annex 3 ...*" and taking into account the constituent data and methodology ..." to determine whether Current AMS for beef was to be included in Current Total AMS. Thus, in order to reach a finding on the complaining parties' claim, the Panel in this case had to ascertain the appropriate "commitment levels" in Korea's Schedule, and had to calculate Current AMS for beef "in accordance with the provisions of Annex 3 ..." to determine whether Current AMS for beef was to be included in Current Total AMS.

87. It is true that, as Korea states, the panel requests in this dispute do not explicitly refer to the "commitment levels" in Korea's Schedule or to "Annex 3" of the *Agreement on Agriculture*. In *Argentina – Safeguard Measures on Imports of Footwear*, however, we held that the "terms of Article 4.2(c) of the *Agreement on Safeguards* expressly incorporate the provisions of Article 3" of that Agreement.<sup>21</sup> In that case, we stated that "we find it difficult to see how a panel could examine whether a Member had complied with Article 4.2(c) without also referring to the provisions of Article 3 of the *Agreement on Safeguards*."<sup>22</sup> We believe the same approach appropriately applies here. Although the "commitment levels" in Korea's Schedule and "Annex 3" of the *Agreement on Agriculture* were *not explicitly* referred to in the panel requests in this dispute, it is clear that Articles 3 and 6 of the *Agreement on Agriculture*, which were referred to in the panel requests, incorporate those terms, either directly through Articles 3.2 and 6.3, in the case of the "commitment levels", or indirectly through Article 1(a)(ii), in the case of "Annex 3". In our view, the commitment levels in Korea's Schedule and the provisions of Annex 3 were in effect referred to in the complaining parties' panel requests, and were, therefore, within the Panel's terms of reference.

88. It is useful to add that, in deciding which set of figures in Korea's Schedule constituted the true and effective commitment levels of Korea and in determining how Current AMS should be calculated under Annex 3, the Panel did not rule on a separate "claim".<sup>23</sup> Rather, it examined specific arguments related to the claim that Korea's domestic support exceeded its AMS commitment levels.

<sup>21</sup>Appellate Body Report, WT/DS121/AB/R, adopted 12 January 2000, para. 74.

<sup>22</sup>*Ibid.*

<sup>23</sup>We note that in paragraph 800 of its Report, the Panel addressed the United States' "claim" that the Base Total AMS specified in Part IV, Section I of Korea's Schedule was initially miscalculated. The Panel considered that this "claim" was not properly before it. It concluded "that the only measure at issue is Korea's current domestic support for its beef industry in the context of Korea's scheduled commitment levels on domestic support under the *Agreement on Agriculture*". This conclusion of the Panel has not been appealed and is not before us.

In this context, it seems useful to recall our statement in *European Communities – Regime for the Importation, Sale and Distribution of Bananas* that:

... there is a significant difference between the *claims* identified in the request for the establishment of a panel, which establish the panel's terms of reference under Article 7 of the DSU, and the *arguments* supporting those claims, which are set out and progressively clarified in the first written submissions, the rebuttal submissions and the first and second panel meetings with the parties.<sup>24</sup>

The claim of the complaining parties was that Korea's domestic support for beef had increased to the point that this support exceeded Korea's commitment levels for certain specified years. This claim was made under Articles 3, 6 and 7 of the *Agreement on Agriculture*, as stated in both panel requests, and was clearly within the Panel's terms of reference. The Panel's examination of the commitment levels in Korea's Schedule and the calculation methodology in Annex 3 was carried out in the course of assessing arguments related to the complaining parties' claim.

89. For these reasons, we conclude that the Panel did not err in finding that the issue of which set of figures constituted Korea's commitment levels and the issue of whether Current AMS for beef must be calculated in accordance with Annex 3 were within its terms of reference.

#### V. Domestic Support under the *Agreement on Agriculture*

90. In the Panel proceedings, the complaining parties claimed that Korea provided domestic support to its beef industry, measured by Current AMS, in amounts which exceeded *de minimis* levels in 1997 and 1998 and which, therefore, were required to be included in Korea's calculation of Current Total AMS for those years. When domestic support for beef was included in Current Total AMS, they contended, Korea's Current Total AMS exceeded its commitment levels set out in Part IV of its Schedule for those years, contrary to Articles 3 and 6 of the *Agreement on Agriculture*.<sup>25</sup>

91. In addressing the above claim, the Panel ascertained both Korea's commitment levels for 1997 and 1998 and Korea's Current Total AMS for those years. With regard to Korea's commitment levels, the Panel noted that there were two sets of figures in Korea's Schedule in the column entitled "Annual

and final bound commitments level 1995-2004", with one set in brackets and the other set not in brackets. The Panel concluded that the figures *not* in brackets constituted Korea's commitment levels.<sup>26</sup> With regard to Current Total AMS for 1997 and 1998, the Panel first examined whether Current AMS for beef exceeded the 10 per cent *de minimis* level set out in Article 6.4 of the *Agreement on Agriculture*. The Panel found that Current AMS for beef exceeded the *de minimis* level, and, therefore, was required to be included in Current Total AMS, and that Korea's failure to include Current AMS for beef in Current Total AMS was inconsistent with Article 7.2(a) of the *Agreement on Agriculture*.<sup>27</sup> The Panel then compared Current Total AMS for 1997 and 1998 with Korea's commitment levels for those years, and concluded that Current Total AMS exceeded the commitment levels, contrary to Article 3.2 of the *Agreement on Agriculture*.<sup>28</sup>

92. On appeal, Korea argues that the Panel's conclusion that Korea exceeded its commitment levels for 1997 and 1998 was in error, for two reasons. First, Korea's view is that the Panel's finding that Korea's commitment levels, as set out in its Schedule, comprise the figures not in brackets is wrong. According to Korea, the commitment levels are, in fact, embodied in the figures in brackets, as Note 1 of Supporting Table 6 of Korea's Schedule makes clear.<sup>29</sup> Second, Korea contends that the Panel's conclusion that Current AMS for beef must be included in Current Total AMS was also wrong. According to Korea, the Panel mistakenly looked to Annex 3 of the *Agreement on Agriculture* in order to calculate the Current AMS for beef, failing to rely instead on the "constituent data and methodology" provided in Korea's Schedule, as required by Articles 1(a)(i) and 1(h)(ii). Korea claims that its Current AMS for beef was properly calculated, on the basis of "constituent data and methodology" in its Schedule, and is less than the *de minimis* level established in Article 6.4 of the *Agreement on Agriculture*. Therefore, Korea argues, Current AMS for beef need not be included in Current Total AMS.<sup>30</sup>

93. The issue before us on appeal has two parts: did the Panel err in finding, firstly, that Korea failed to include Current AMS for beef in Current Total AMS, contrary to Article 7.2(a) of the *Agreement on Agriculture*, and in finding, secondly, that, contrary to Article 3.2 of the *Agreement on Agriculture*, Korea's Current Total AMS exceeds the commitment levels in Part IV of its Schedule for 1997 and 1998? In examining the component parts of this issue, it is necessary for us to ascertain two sets of figures: the figures which constitute Korea's commitment levels for 1997 and 1998, and

<sup>26</sup>Panel Report, para. 821.

<sup>27</sup>*Ibid.*, para. 841.

<sup>28</sup>*Ibid.*, para. 843.

<sup>29</sup>Korea's appellant's submission, paras. 26-54.

<sup>30</sup>*Ibid.*, paras. 79-90.

the figures for Korea's Current Total AMS for 1997 and 1998. We turn first to an examination of Korea's commitment levels for 1997 and 1998.

A. *Korea's Commitment Levels for 1997 and 1998*

94. In Korea's Schedule LX, Part IV, Section I, entitled "Domestic Support: Total AMS Commitments", Korea has provided annual bound commitment levels for domestic support for agriculture for the period 1995-2004. The Schedule contains three columns, as follows:

Base Total AMS	Annual and final bound commitments level 1995 - 2004		Relevant Supporting Tables and document reference
	1	2	
	bil. ₩	bil. ₩	
1,718.6	1995: 1,695.74 1996: 1,672.90 1997: 1,650.03 1998: 1,627.17 1999: 1,604.32 2000: 1,581.46 2001: 1,558.60 2002: 1,535.74 2003: 1,512.89 2004: 1,490.00	(2,182.55)*Note 1 (2,105.60) (2,028.65) (1,951.70) (1,874.75) (1,797.80) (1,720.85) (1,643.90) (1,566.95) (1,490.00)	AGST/KOR (Supporting Table 4, 5, 6, 7, 8 and 10)

₩ = Korean Won

\*Note 1 : Refer to Note 1 of Supporting Table 6 about the numbers in parentheses.

Korea's commitment levels are in Column 2, entitled "Annual and final bound commitments level 1995-2004". This column contains two sets of figures pertaining to the years 1995-2004: one set in brackets, and one set not in brackets.

95. In its findings, the Panel referred to part of Korea's Schedule. In particular, the Panel referred to the figures in Column 1 and Column 2. However, the Panel did not refer to "\* Note 1" in Column 2, nor to the explanatory information set out in Note 1, and did not reprint Column 3.<sup>31</sup> The Panel concluded that the set of figures not in brackets constitutes Korea's commitment levels. In support of its conclusion, the Panel noted that "the unbracketed figures in Korea's Schedule are derived from, and directly linked to, the 'Base Total AMS'". By contrast, the figures in the column with brackets "bear no such relationship to the specified 'Base Total AMS' of 1,718.60 billion won."<sup>32</sup> Therefore, Korea's commitment level for 1997 is 1,650.03 billion won, while the commitment level

<sup>31</sup>Panel Report, para. 820.

<sup>32</sup>*Ibid.*, para. 822.

for 1998 is 1,627.17 billion won.<sup>33</sup> On appeal, Korea argues that the Panel's conclusion was in error.<sup>34</sup>

96. Examining this issue requires us to interpret Korea's Schedule. At the outset, we note, as we have previously stated in *European Communities – Customs Classification of Certain Computer Equipment*, that:

A Schedule is ... an integral part of the GATT 1994 ... . Therefore, the concessions provided for in that schedule are part of the terms of the treaty. As such, the only rules which may be applied in interpreting the meaning of a concession are the general rules of treaty interpretation set out in the *Vienna Convention*.<sup>35</sup>

Thus, we now examine Korea's Schedule in light of the rules of treaty interpretation. We begin with the ordinary meaning of the terms of the Schedule, in their context and in the light of the object and purpose of the treaty, in accordance with Article 31(1) of the *Vienna Convention*.

97. The Panel examined the two sets of figures provided by Korea, as well as the figure for "Base Total AMS". However, as is clear from the table in Korea's Schedule LX, Part IV, Section I, which has been reprinted in paragraph 94 above, the two sets of figures do not exist in isolation. Rather, to the right of the two sets of figures is the notation "\* Note 1". At the bottom of Korea's Schedule, there is "\* Note 1" which states: "Refer to Note 1 of Supporting Table 6 about the numbers in parentheses." The Panel, in its reasoning, referred to the set of figures in Column 1 and Column 2, but did *not* refer to "\* Note 1", nor did it consider the terms of "\* Note 1".<sup>36</sup> An examination of the ordinary meaning of the terms of a treaty must take into account *all* of those terms, and, accordingly, we proceed with an examination of Korea's Schedule, including Note 1 of Supporting Table 6. In our view, the Panel's examination of the "ordinary meaning" of Korea's Schedule was not done in accordance with the rules of interpretation of general international law as codified in the *Vienna Convention*.

98. Supporting Table 6 is entitled "Aggregate Measurements of Support: Market Price Support". This table provides the supporting figures for the commitment levels set out in Part IV, Section I of Korea's Schedule LX, that is, the figures used to calculate the commitment levels. Supporting figures are provided for rice, barley, soybean, maize (corn) and rape seeds. In respect of each product, the AMS for each of the years 1989-1991 is provided, along with an average AMS level for the years

<sup>33</sup>See Panel Report, para. 843.

<sup>34</sup>Korea's appellant's submission, paras. 26-54.

<sup>35</sup>Appellate Body Report, WT/DS62/AB/R, WT/DS67/AB/R, WT/DS68/AB/R, adopted 22 June 1998, para. 84.

<sup>36</sup>See Panel Report, paras. 820-823.

1989-1991. For rice, AMS figures for 1993 are given as well. The figures for each product were combined in order to obtain a Base Total AMS figure which could then be used to determine commitment levels for the years 1995-2004.

99. Note 1 of Supporting Table 6 reads as follows:

The AMS for rice has been calculated based on 1993 market price support instead of 1989-1991 average. The Final Bound Commitment level in 2004, however, is the level reduced by 13.3% from the 1989-1991 average Base Total AMS.<sup>37</sup>

As the Panel did not consider Note 1 at the bottom of Korea's Schedule LX, Part IV, Section I, it did not consider Note 1 of Supporting Table 6 either.

100. In interpreting Note 1 of Supporting Table 6, we look again at its ordinary meaning. The first sentence of this Note indicates that the AMS calculations for *rice* are based on 1993 figures, whereas for products other than rice, the AMS figures are based on the 1989-1991 average amounts.

101. The second sentence of Note 1 of Supporting Table 6 makes clear that the final bound commitment level for 2004 has been determined by reducing the 1989-1991 average Base Total AMS by 13.3 per cent.

102. We note that the use of the term "however" ordinarily indicates a contrast between two things, and lends support to Korea's position. The contrast here is the following: whereas the starting AMS amount is calculated using the 1989-1991 figures for products other than rice and the 1993 figures for rice, the Final Bound Commitment level for 2004 is calculated based on the 1989-1991 average Base Total AMS, which relies on 1989-1991 figures for *all* products, including rice. It appears to us that what Korea stated in Note 1 of Supporting Table 6 was this: the starting AMS commitment level for 1995 is determined by using AMS calculations relying on base years of 1989-1991 for all products except rice, and 1993 for rice; "however", the final target commitment level for 2004 is based on the Base Total AMS figure which was derived by using the base years 1989-1991 for *all* products. The starting AMS commitment level figure for 1995 (2182.55 billion won) was reduced in equal annual amounts over the period from 1995 to 2004 in order to reach the final target commitment level for 2004 (1490.00 billion won). The reduced commitment levels for each year over the period 1995-2004, the calculation of which has been described by Korea in Note 1 of Supporting Table 6, are set

out in the figures in brackets. It follows from the wording of Korea's Schedule LX, Part IV, Section I, read together with Note 1 of the Supporting Table 6, that Korea's AMS commitment levels for 1995-2004 are not represented, as the Panel concluded, by the figures not in brackets, but, rather, as Korea contends, by the figures in brackets.

103. The above view is reflected in Korea's subsequent statements before the Committee on Agriculture. At a November 1996 Committee on Agriculture meeting, New Zealand asked Korea this question: "Noted that Korea's Schedule contains two sets of figures regarding annual and final bound commitment levels. Which set is accurate?" Korea responded as follows:

*The figures in brackets correspond to Korea's real annual commitment level, using the 1993 base period for rice and the 1989-1991 base period for other products, as indicated in the footnote of Korea's Schedule LX. The said calculation and annual commitment level of AMS were already reviewed and agreed upon by Member countries in March 1994. The other set of figures corresponds to the annual commitment using the base period of 1989-1991 for all the products.*<sup>38</sup> (emphasis added)

104. Furthermore, in its official annual Notifications to the Committee on Agriculture concerning domestic support commitments for 1995 to 1998, Korea made reference to its commitment level for the period in question. In each Notification, the figure Korea provided was the relevant commitment level from Korea's Schedule set out in the figures in brackets. Next to the AMS figure in each Notification is a note which says "See Note 1 of Supporting Table 6 in G/AG/AGST/KOR".<sup>39</sup>

105. For these reasons, we conclude that Korea's commitment levels in Part IV, Section I of its Schedule LX are denoted by the figures in the Column entitled "Annual and final bound commitments level 1995-2004" which are in brackets. Thus, Korea's commitment level is 2,028.65 billion won for the year 1997, and 1,951.70 billion won for the year 1998.

106. We turn next to an examination of Korea's Current Total AMS for 1997 and 1998, to determine whether Korea's Current Total AMS for these years exceeded its commitment levels for those same years.

<sup>38</sup>G/AG/R/9, 17 January 1997.

<sup>39</sup>See G/AG/N/KOR/24, 25 August 1999; G/AG/N/KOR/18, 16 September 1998; G/AG/N/KOR/14, 15 September 1997; G/AG/N/KOR/7, 18 November 1996.

<sup>37</sup>G/AG/AGST/KOR, p. 8.

B. *Korea's Current Total AMS for 1997 and 1998*

107. In its Notifications to the Committee on Agriculture for 1997 and 1998, Korea provided figures for the Current Total AMS for those years. Korea claimed that for 1997 it provided Current Total AMS of 1,936.95 billion won, and for 1998 it provided 1,562.77 billion won.<sup>40</sup> The complaining parties argue that Korea's Current Total AMS as provided in its Notifications was calculated improperly, as Korea did not include Current AMS for beef in its Current Total AMS. The United States contends that when Current AMS for beef is included in Current Total AMS, as required, Current Total AMS for both 1997 and 1998 exceeded Korea's commitment levels for 1997 and 1998, whereas Australia limits its contention to 1997.<sup>41</sup>

108. The Panel found that Korea's Current AMS for beef did exceed the *de minimis* level for 1997 and 1998, and, therefore, was required to be included in Current Total AMS, under Article 7.2(a) of the *Agreement on Agriculture*.<sup>42</sup> The Panel then compared Korea's Current Total AMS to Korea's commitment levels for 1997 and 1998, and concluded that Current Total AMS exceeded the commitment levels, contrary to Article 3.2 of the *Agreement on Agriculture*.<sup>43</sup>

109. On appeal, Korea contends that the Panel's conclusion that Current AMS for beef must be included in Current Total AMS is incorrect. According to Korea, the Panel mistakenly looked to Annex 3 of the *Agreement on Agriculture* in order to calculate the Current AMS for beef, while failing to take into account the "constituent data and methodology" provided in Korea's Schedule, as required by Articles 1(a)(ii) and 1(b)(ii) of the *Agreement on Agriculture*. Korea claims that its Current AMS for beef was properly calculated in its Notifications to the Committee on Agriculture, based on the "constituent data and methodology" in its Schedule, and that consequently this Current AMS fell below the *de minimis* level established in Article 6.4 of the *Agreement on Agriculture*. Therefore, Korea argues, the Current AMS for beef need not be included in the Current Total AMS, and Current Total AMS was properly calculated in its Notifications.<sup>44</sup>

110. In examining this issue, we need to determine first whether Current AMS for beef for 1997 and 1998 must be included in Korea's Current Total AMS for those years. We recall that Article 6.4 of the *Agreement on Agriculture* states that:

A Member shall not be required to include in the calculation of its Current Total AMS and shall not be required to reduce:

- (i) product-specific domestic support which would otherwise be required to be included in a Member's calculation of its Current AMS where such support does not exceed 5 per cent of that Member's total value of production of a basic agricultural product during the relevant year;

...

For developing country Members the *de minimis* percentage level under this paragraph is 10 per cent.<sup>45</sup> Thus, Korea's Current AMS for beef must be included in Current Total AMS only if the Current AMS for beef exceeds the 10 per cent *de minimis* requirement applicable in respect of developing country Members.

111. To determine whether Korea's Current AMS for beef exceeds 10 per cent of total value of beef production, we refer again to Article 1(a)(ii) of the *Agreement on Agriculture*, which defines Current AMS. Under this provision, Current AMS is to be

calculated *in accordance with* the provisions of Annex 3 of this Agreement and *taking into account* the constituent data and methodology used in the tables of supporting material incorporated by reference in Part IV of the Member's Schedule; ... (emphasis added)

Article 1(a)(ii) contains two express requirements for calculating Current AMS. First, Current AMS is to be "calculated *in accordance with* the provisions of Annex 3 of this Agreement". The ordinary meaning of "accordance" is "agreement, conformity, harmony".<sup>46</sup> Thus, Current AMS must be calculated in "conformity" with the provisions of Annex 3. Second, Article 1(a)(ii) provides that the calculation of Current AMS is to be made while "taking into account the constituent data and methodology used in the tables of supporting material incorporated by reference in Part IV of the Member's Schedule." "Take into account" is defined as "take into consideration, notice".<sup>47</sup> Thus, when Current AMS is calculated, the "constituent data and methodology" in a Member's Schedule must be "taken into account", that is, it must be "considered".<sup>48</sup>

<sup>45</sup>Article 6.4(b) of the *Agreement on Agriculture*.

<sup>46</sup>*The New Shorter Oxford English Dictionary*, (Clarendon Press, 1993), Vol. 1, p. 15.

<sup>47</sup>*Ibid.*

<sup>48</sup>We note that this difference is not reflected in the wording of the definition of Current Total AMS in Article 1(b). Article 1(h)(ii) provides that Current Total AMS is to be calculated "in accordance with the provisions of this Agreement, including Article 6, and with the constituent data and methodology used in the tables of supporting material incorporated by reference in Part IV of the Member's Schedule". (emphasis added)

<sup>40</sup>See G/AG/N/KOR/24, 25 August 1999; G/AG/N/KOR/18, 16 September 1998.

<sup>41</sup>See *supra*, footnote 25.

<sup>42</sup>Panel Report, para. 841.

<sup>43</sup>*Ibid.*, para. 843.

<sup>44</sup>Korea's appellant's submission, paras. 79-90.

112. Looking at the wording of Article 1(a)(ii) itself, it seems to us that this provision attributes higher priority to "the provisions of Annex 3" than to the "constituent data and methodology". From the viewpoint of ordinary meaning, the term "in accordance with" reflects a more rigorous standard than the term "taking into account".

113. We note, however, that the Panel did not base its reasoning on this apparent hierarchy as between "the provisions of Annex 3" and the "constituent data and methodology".<sup>49</sup> Instead, the Panel considered that where no support was included in the base period calculation for a given product, there is no "constituent data or methodology" to refer to, so that the only means available for calculating domestic support is that provided in Annex 3.<sup>50</sup> As beef had not been included in Supporting Table 6 of Korea's Schedule LX, Part IV, Section I, the Panel concluded that Annex 3 alone is applicable for the purposes of calculating current non-exempt support in respect of Korean beef.<sup>51</sup>

114. In the circumstances of the present case, it is not necessary to decide how a conflict between "the provisions of Annex 3" and the "constituent data and methodology used in the tables of supporting material incorporated by reference in Part IV of the Member's Schedule" would have to be resolved in principle. As the Panel has found, in this case, there simply are no constituent data and methodology for beef.<sup>52</sup> Assuming *arguendo* that one would be justified – in spite of the wording of Article 1(a)(ii) – to give priority to constituent data and methodology used in the tables of supporting material over the guidance of Annex 3, for products entering into the calculation of the Base Total AMS, such a step would seem to us to be unwarranted in calculating Current AMS for a product which did *not* enter into the Base Total AMS calculation. We do not believe that the *Agreement on Agriculture* would sustain such an extrapolation. We, therefore, agree with the Panel that, in this case, Current AMS for beef has to be calculated in accordance with the provisions of Annex 3, and with these provisions alone.

115. Korea has argued that:

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<sup>49</sup>On the contrary, the Panel opines that the "constituent data and methodology" has an important role to play in ensuring that the calculation of support to any given product is calculated in subsequent years consistently with support calculated in the base period. Panel Report, para. 811.

<sup>50</sup>*Ibid.*

<sup>51</sup>*Ibid.*, para. 812.

<sup>52</sup>*Ibid.* In other words, there is no *data* (product) in respect of which the *methodology* of Schedule LX of Korea (that is, the use of figures for the years 1989-1991) could be applied, in so far as beef is concerned.

National schedules on the reduction of subsidies in favour of agricultural products ... can be understood as multi-year equations. One side of the equation includes the commitment level for a given year, while the other side of the equation includes the actual AMS for the same year. Thus, for the equation to be meaningful, both sides of the equation should be based on the same sets of data and methodology. ... Using one methodology for commitment levels and another methodology for actual AMS undermines comparability between the two, and leads to unfair results.<sup>53</sup>

We believe that it is not necessary or appropriate to conceive of the pertinent provisions of the *Agreement on Agriculture* as establishing "multi-year equations". The treaty definitions of both AMS and Total AMS, set out in Articles 1(a) and 1(b) respectively, do provide a specific methodology for calculating Current AMS and Current Total AMS in respect of a particular year during the implementation period. However, with respect to the other side of a hypothetical equation, the relevant treaty provisions do *not* provide for any particular mode of calculation of the "Base Total AMS", from which figure the commitment levels for particular years of the implementation period are arithmetically derived. Article 1(a)(i) of the *Agreement on Agriculture* dealing with AMS states that "with respect to support provided during the base period", a treaty interpreter needs only to go to "the relevant tables of supporting material incorporated by reference in Part IV of a Member's Schedule ...". (emphasis added) Similarly, Article 1(h)(i) dealing with Total AMS, states that "with respect to support provided during the base period (i.e., the 'Base Total AMS') and the maximum support permitted to be provided during any year of the implementation period or thereafter (i.e., the 'Annual and Final Bound Commitment Levels')", a treaty interpreter needs only to go to what is "specified in Part IV of a Member's Schedule ...". (emphasis added) Thus, for purposes of determining whether a Member has exceeded its commitment levels, Base Total AMS, and the commitment levels resulting or derived therefrom, are not themselves formulae to be worked out, but simply absolute figures set out in the Schedule of the Member concerned. As a result, Current Total AMS which is calculated according to Annex 3, is compared to the commitment level for a given year that is already specified as a given, absolute, figure in the Member's Schedule.

116. We examine next Annex 3, entitled: "Domestic Support: Calculation of Aggregate Measurement of Support". Paragraphs 8 and 9 of Annex 3 provide the following definition of "market price support", the particular form of domestic support at issue here:

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<sup>53</sup>Korea's appellant's submission, para. 63.

... *market price support* shall be calculated using the gap between a fixed external reference price and the applied administered price multiplied by the *quantity of production eligible to receive* the applied administered price. Budgetary payments made to maintain this gap, such as buying-in or storage costs, shall not be included in the AMS.

The *fixed external reference price shall be based on the years 1986 to 1988* and shall generally be the average f.o.b. unit value for the basic agricultural product concerned in a net exporting country and the average c.i.f. unit value for the basic agricultural product concerned in a net importing country in the base period. The fixed reference price may be adjusted for quality differences as necessary. (emphasis added)

Thus, under Annex 3, "market price support" is calculated by taking the difference between a fixed external reference price and the applied administered price, and multiplying that difference by "the quantity of *production eligible* to receive the applied administered price". (emphasis added) The fixed external reference price "shall be *based on the years 1986 to 1988*". (emphasis added)

117. The Panel found that in both 1997 and 1998 Korea miscalculated its fixed external reference price, contrary to Article 6 and paragraph 9 of Annex 3, by using a fixed external reference price based on data for 1989-1991.<sup>54</sup> Korea justifies this choice by invoking the "constituent data and methodology" used in its Supporting Table 6 for all products other than rice, i.e., for barley, soybean, maize (corn) and rape seeds. In Supporting Table 6, all these products use the period 1989-1991 for the fixed external reference price.<sup>55</sup>

118. We have already explained above that we share the Panel's view with respect to Korea's argument on "constituent data and methodology" used in the table of supporting material. We agree with the Panel that, in this case, Current AMS for beef has to be calculated in accordance with Annex 3. According to Annex 3, "[t]he fixed external reference price shall be based on the years 1986 to 1988". We, therefore, also agree with the Panel that in calculating the product specific AMS for beef for the years 1997 and 1998, Korea should have used an external reference price based on data for 1986-1988, instead of data for 1989-1991.

119. The Panel found that, in calculating the Current AMS for beef for the years 1997 and 1998, Korea made a further mistake. In determining its market price support for beef, Korea used the quantity of Hanwoo cattle actually purchased. The Panel found that "[t]he actual quantity of purchases is not relevant in the calculation of market price support. Korea, by indicating its intent to

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<sup>54</sup>Panel Report, para. 830.

<sup>55</sup>Korea's appellant's submission, paras. 79-80.

purchase specified quantities, made them eligible to receive the applied administered price, and consequently affected and supported the price of all such products".<sup>56</sup>

120. We share the Panel's view that the words "production *eligible* to receive the applied administered price" in paragraph 8 of Annex 3 have a different meaning in ordinary usage from "production *actually purchased*". The ordinary meaning of "eligible" is "fit or *entitled* to be chosen".<sup>57</sup> Thus, "production eligible" refers to production that is "fit or entitled" to be purchased rather than production that was actually purchased. In establishing its program for future market price support, a government is able to define and to limit "eligible" production. Production actually purchased may often be less than eligible production.

121. In the present case, Korea, in effect, declared the quantity of "eligible production" when it announced in January, 1997, that it would purchase 500 head per day of Hanwoo cattle above 500 kg within the 27 January to 31 December 1997 period, which would be 170,000 head of cattle for the 1997 calendar year.<sup>58</sup> That figure, under paragraph 8 of Annex 3, accordingly constitutes the quantity of "eligible production". While there may be nothing under the *Agreement on Agriculture* to prevent Korea from changing the quantity of "eligible production", Korea did not do so, so far as the record of this case shows. Korea instead simply purchased a lesser number of cattle by ceasing its purchases.

122. Korea argues that it is entitled to calculate market price support in 1997 and 1998 by using actual purchases, because it used actual purchases in its calculations in the tables of supporting material in its Schedule. We recall that we share the Panel's view that for beef, "constituent data and methodology" do not exist in the Schedule, as beef did not enter into the calculation of Korea's initial Base Total AMS. We, therefore, agree with the Panel's finding that Korea erred in calculating market price support in 1997 and 1998 by using the amount of production actually purchased, instead of production declared eligible to receive the applied administered price, according to the provisions of paragraph 8 of Annex 3.

123. Having reached the conclusion that Korea had miscalculated its market price support in 1997 and 1998, the Panel attempted to evaluate correctly Korea's Current AMS for beef. In doing so, the Panel stated that "[f]or reasons of clarity and simplicity", it would rely on market price support

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<sup>56</sup>Panel Report, para. 831.

<sup>57</sup>*The Concise Oxford English Dictionary*, (Clarendon Press, 1995), p. 438.

<sup>58</sup>Panel Report, para. 834.

calculations submitted by New Zealand for Korea's Current AMS for beef.<sup>59</sup> Based on these calculations, the Panel found that Korea's AMS for beef had exceeded the 10 per cent *de minimis* threshold referred to in Article 6.4(b) of the *Agreement on Agriculture* in 1997 and 1998.<sup>60</sup>

124. We note that in calculating Korea's Current AMS for beef, New Zealand uses – like Korea – a fixed external reference price based on 1989-1991 data. As we have found above, the use of such an external reference price is incompatible with paragraph 9 of Annex 3, which requires an external reference price based on the years 1986-1988.

125. The Panel was aware of this incompatibility, but seemed to assume that New Zealand's reference to 1989-1991 data benefitted, rather than harmed, Korea.<sup>61</sup> This could be the case if the 1989-1991 data would result in a higher external reference price than the one prescribed by paragraph 9 of Annex 3, i.e., the external reference price based on the years 1986-1988. There is, however, no indication in the Panel Report of the level of the external reference price for the years 1986-1988. Furthermore, neither the Panel Report nor the Panel record contain any elements which might allow us to determine the level of such an external reference price.<sup>62</sup>

126. We, therefore, must reverse the Panel's finding that Korea exceeded the 10 per cent *de minimis* threshold of Current AMS for beef in 1997 and 1998, and the consequent finding that the failure to include Current AMS for beef in Current Total AMS in these years is inconsistent with Articles 6 and 7.2(a) of the *Agreement on Agriculture*.

127. As a consequence, we must also reverse the Panel's finding that, in 1997 and 1998, Korea's Current Total AMS exceeded Korea's commitment levels, as specified in Part IV, Section I of its Schedule, in violation of Article 3.2 of the *Agreement on Agriculture*.

<sup>59</sup>Panel Report, para. 838.

<sup>60</sup>*Ibid.*, para. 840.

<sup>61</sup>This seems to be the meaning of the words "inflating Korea's legitimate level of domestic support" in footnote 442 of the Panel Report which reads as follows:

The Panel notes that for this recalculation of Korea's FERP, New Zealand even used 1989-1991 data (inflating Korea's legitimate level of domestic support), contrary to the Panel's conclusion that pursuant to Annex 3 a 1986-1988 FERP should have been employed.

<sup>62</sup>In *Australia – Measures Affecting the Importation of Salmon* we stated that where we have reversed a finding of a panel, we should attempt to complete a panel's legal analysis "to the extent possible on the basis of the factual findings of the Panel and/or of undisputed facts in the Panel record". Appellate Body Report, WT/DS18/AB/R, adopted 6 November 1998, para. 118. See also Appellate Body Report, *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/AB/R, WT/DS142/AB/R, adopted 19 June 2000, para. 133.

128. We should, however, stress that, as there is insufficient information in the Panel record to allow determination of whether Current AMS for beef exceeded the *de minimis* threshold in 1997 and 1998, and, therefore, had to be included in Current Total AMS, we reach no conclusion as to whether or not Korea acted inconsistently with Articles 6 and 7.2(a) of the *Agreement on Agriculture*.

129. Furthermore, as a determination of Current Total AMS cannot be made without first ascertaining Current AMS for beef, no Current Total AMS can be calculated for 1997 and 1998. As a result, there is no basis on which we can reach a conclusion on the issue of whether or not Korea exceeded its commitment levels in Part IV of its Schedule for 1997 and 1998, contrary to Article 3.2 of the *Agreement on Agriculture*.

## VI. Dual Retail System

### A. Article III:4 of the GATT 1994

130. The Panel found that Korea's dual retail system for beef accords treatment less favourable to imported beef than to like Korean beef, and is, thus, inconsistent with Article III:4 of the GATT 1994. This finding was based on the Panel's view that any measure based exclusively on criteria relating to the origin of a product is inconsistent with Article III:4.<sup>63</sup> The finding was also based on the Panel's assessment of how the dual retail system modifies the conditions of competition between imported and like domestic beef in the Korean market.<sup>64</sup>

131. Korea argues on appeal that the dual retail system does not accord treatment less favourable to imported beef than to like domestic beef. For Korea, the dual retail system does not *on its face* violate Article III:4, since there is "perfect regulatory symmetry" in the separation of imported and domestic beef at the retail level, and there is "no regulatory barrier" which prevents traders from converting from one type of retail store to another.<sup>65</sup> Nor, Korea argues, does the dual retail system violate Article III:4 *de facto*, and the Panel's conclusion to the contrary was not based on a proper empirical analysis of the Korean beef market.<sup>66</sup>

<sup>63</sup>Panel Report, para. 627.

<sup>64</sup>*Ibid.*, paras. 631-637.

<sup>65</sup>Korea's appellant's submission, paras. 119-126.

<sup>66</sup>*Ibid.*, paras. 127-156.

132. Article III:4 of the GATT 1994 reads in relevant part:

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

133. For a violation of Article III:4 to be established, three elements must be satisfied: that the imported and domestic products at issue are "like products"; that the measure at issue is a "law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use"; and that the imported products are accorded "less favourable" treatment than that accorded to like domestic products. Only the last element – "less favourable" treatment – is disputed by the parties and is at issue in this appeal.

134. The Panel began its analysis of the phrase "treatment no less favourable" by reviewing past GATT and WTO cases. It found that "treatment no less favourable" under Article III:4 requires that a Member accord to imported products "effective equality of opportunities" with like domestic products in respect of the application of laws, regulations and requirements.<sup>67</sup> The Panel concluded its review of the case law by stating:

Any regulatory distinction that is based exclusively on criteria relating to the nationality or the origin of the products is incompatible with Article III and this conclusion can be reached even in the absence of any imports (as hypothetical imports can be used to reach this conclusion) confirming that there is no need to demonstrate the actual and specific trade effects of a measure for it to be found in violation of Article III. The object of Article III:4 is, thus, to guarantee effective market access to imported products and to ensure that the latter are offered the same market opportunities as domestic products.<sup>68</sup>

135. The Panel stated that "any regulatory distinction that is based exclusively on criteria relating to the nationality or origin" of products is incompatible with Article III:4. We observe, however, that

Article III:4 requires only that a measure accord treatment to imported products that is "no less favourable" than that accorded to like domestic products. A measure that provides treatment to imported products that is *different* from that accorded to like domestic products is not necessarily inconsistent with Article III:4, as long as the treatment provided by the measure is "no less favourable". According to "treatment no less favourable" means, as we have previously said, according to *conditions of competition* no less favourable to the imported product than to the like domestic product. In *Japan – Taxes on Alcoholic Beverages*, we described the legal standard in Article III as follows:

The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. More specifically, the purpose of Article III "is to ensure that internal measures 'not be applied to imported or domestic products so as to afford protection to domestic production'". Toward this end, Article III obliges Members of the WTO to provide *equality of competitive conditions* for imported products in relation to domestic products. "[T]he intention of the drafters of the Agreement was clearly to treat the imported products in the same way as the like domestic products once they had been cleared through customs. Otherwise indirect protection could be given".<sup>69</sup> (emphasis added)

136. This interpretation, which focuses on the *conditions of competition* between imported and domestic like products, implies that a measure according formally *different* treatment to imported products does not *per se*, that is, necessarily, violate Article III:4. In *United States – Section 337*, this point was persuasively made. In that case, the panel had to determine whether United States patent enforcement procedures, which were formally different for imported and for domestic products, violated Article III:4. That panel said:

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<sup>69</sup> Appellate Body Report, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, pp. 16-17. The original passage contains footnotes. The second sentence is footnoted to *United States – Section 337 of the Tariff Act of 1930* ("*United States – Section 337*"), BISD 36S/345, para. 5.10. The third sentence is footnoted to *United States – Taxes on Petroleum and Certain Imported Substances*, BISD 34S/136, para. 5.19; and *Japan – Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.5(b). The fifth sentence is footnoted to *Italian Discrimination Against Imported Agricultural Machinery*, BISD 7S/60, para. 11.

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<sup>67</sup> Panel Report, para. 624.

<sup>68</sup> *Ibid.*, para. 627. (footnotes omitted)

On the one hand, contracting parties may apply to imported products *different* formal legal requirements if doing so would accord imported products more favourable treatment. On the other hand, it also has to be recognised that there may be cases where the application of formally *identical* legal provisions would in practice accord less favourable treatment to imported products and a contracting party might thus have to apply different legal provisions to imported products to ensure that the treatment accorded them is in fact no less favourable. For these reasons, the mere fact that imported products are subject under Section 337 to legal provisions that are different from those applying to products of national origin is in itself not conclusive in establishing inconsistency with Article III:4.<sup>70</sup> (emphasis added)

137. A formal difference in treatment between imported and like domestic products is thus neither necessary, nor sufficient, to show a violation of Article III:4. Whether or not imported products are treated "less favourably" than like domestic products should be assessed instead by examining whether a measure modifies the *conditions of competition* in the relevant market to the detriment of imported products.

138. We conclude that the Panel erred in its general interpretation that "[a]ny regulatory distinction that is based exclusively on criteria relating to the nationality or the origin of the products is incompatible with Article III."<sup>71</sup>

139. The Panel went on, however, to examine the conditions of competition between imported and like domestic beef in the Korean market. The Panel gave several reasons why it believed that the dual retail system alters the conditions of competition in the Korean market in favour of domestic beef. First, it found that the dual retail system would "limit the possibility for consumers to compare imported and domestic products", and thereby "reduce opportunities for imported products to compete directly with domestic products".<sup>72</sup> Second, the Panel found that, under the dual retail system, "the only way an imported product can get on the shelves is if the retailer agrees to substitute it, not only for one but for all existing like domestic products." This disadvantage would be more serious when the market share of imports (as is the case with imported beef) is small.<sup>73</sup> Third, the Panel found that the dual retail system, by excluding imported beef from "the vast majority of sales outlets", limits the potential market opportunities for imported beef. This would apply particularly to products

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<sup>70</sup>*United States – Section 337, supra*, footnote 69, paragraph 5.11.

<sup>71</sup>Panel Report, para. 627.

<sup>72</sup>*Ibid.*, para. 631.

<sup>73</sup>*Ibid.*, para. 632.

"consumed on a daily basis", like beef, where consumers may not be willing to "shop around".<sup>74</sup> Fourth, the Panel found that the dual retail system imposes more costs on the imported product, since the domestic product will tend to continue to be sold from existing retail stores, whereas imported beef will require new stores to be established.<sup>75</sup> Fifth, the Panel found that the dual retail system "encourages the perception that imported and domestic beef are different, when they are in fact like products belonging to the same market", which gives a competitive advantage to domestic beef, "based on criteria not related to the products themselves".<sup>76</sup> Sixth, the Panel found that the dual retail system "facilitates the maintenance of a price differential" to the advantage of domestic beef.<sup>77</sup>

140. On appeal, Korea argues that the Panel's analysis of the conditions of competition in the Korean market is seriously flawed, relying largely on speculation rather than on factual analysis. Korea maintains that the dual retail system does not deny consumers the possibility to make comparisons, and the numbers of outlets selling imported beef, as compared with outlets selling domestic beef, does not support the Panel's findings. Korea argues, furthermore, that the dual retail system neither adds to the costs of, nor shelters high prices for, domestic beef.<sup>78</sup>

141. It will be seen below that we share the ultimate conclusion of the Panel in respect of the consistency of the dual retail system for beef with Article III:4 of the GATT 1994. Portions, however, of the Panel's analysis *en route* to that conclusion appear to us problematic. For instance, while limitation of the ability to compare visually two products, local and imported, at the point of sale may have resulted from the dual retail system, such limitation does not, in our view, necessarily reduce the opportunity for the imported product to compete "directly" or on "an equal footing" with the domestic product.<sup>79</sup> Again, even if we were to accept that the dual retail system "encourages" the perception of consumers that imported and domestic beef are "different", we do not think it has been demonstrated that such encouragement necessarily implies a competitive advantage for domestic beef.<sup>80</sup> Circumstances like limitation of "side-by-side" comparison and "encouragement" of consumer perceptions of "differences" may be simply incidental effects of the dual retail system without decisive implications for the issue of consistency with Article III:4.

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<sup>74</sup>Panel Report, para. 633.

<sup>75</sup>*Ibid.*, para. 634.

<sup>76</sup>*Ibid.*

<sup>77</sup>*Ibid.*

<sup>78</sup>Korea's appellant's submission, paras. 101, 127-156.

<sup>79</sup>See Panel Report, para. 633.

<sup>80</sup>*Ibid.*, para. 634.

142. We believe that a more direct, and perhaps simpler, approach to the dual retail system of Korea may be usefully followed in the present case. In the following paragraphs, we seek to focus on what appears to us to be the fundamental thrust and effect of the measure itself.

143. Korean law in effect requires the existence of two distinct retail distribution systems so far as beef is concerned: one system for the retail sale of domestic beef and another system for the retail sale of imported beef.<sup>81</sup> A small retailer (that is, a non-supermarket or non-department store) which is a "Specialized Imported Beef Store" may sell any meat *except domestic beef*; any other small retailer may sell any meat *except imported beef*.<sup>82</sup> A large retailer (that is, a supermarket or department store) may sell both imported and domestic beef, as long as the imported beef and domestic beef are sold in separate sales areas.<sup>83</sup> A retailer selling imported beef is required to display a sign reading "Specialized Imported Beef Store".<sup>84</sup>

144. Thus, the Korean measure formally separates the selling of imported beef and domestic beef. However, that formal separation, *in and of itself*, does not necessarily compel the conclusion that the treatment thus accorded to imported beef is less favourable than the treatment accorded to domestic beef.<sup>85</sup> To determine whether the treatment given to imported beef is less favourable than that given to domestic beef, we must, as earlier indicated, inquire into whether or not the Korean dual retail system for beef modifies the *conditions of competition* in the Korean beef market to the disadvantage of the imported product.

145. When beef was first imported into Korea in 1988, the new product simply entered into the pre-existing distribution system that had been handling domestic beef. The beef retail system was a unitary one, and the conditions of competition affecting the sale of beef were the same for both the domestic and the imported product. In 1990, Korea promulgated its dual retail system for beef.<sup>86</sup>

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<sup>81</sup>The essential features of the Korean dual retail system for beef are found in the *Guidelines Concerning Registration and Operation of Specialized Imported Beef Stores*, (61550-81) 29 January 1990, modified on 15 March 1994; and the *Regulations Concerning Sales of Imported Beef* (51550-100), modified on 27 March 1993, 7 April 1994, and 29 June 1998. On 1 October 1999, these two instruments were replaced by the *Management Guideline for Imported Beef*. (Ministry of Agriculture Notice 1999-67), which maintained, however, the basic principles of the dual retail system.

<sup>82</sup>*Guidelines Concerning Registration and Operation of Specialized Imported Beef Stores*, Art. 5(C); *Regulations Concerning Sales of Imported Beef*, Art. 14(5); *Management Guideline for Imported Beef*, Art. 15.

<sup>83</sup>*Guidelines Concerning Registration and Operation of Specialized Imported Beef Stores*, Art. 5(A); *Management Guideline for Imported Beef*, Art. 9(5).

<sup>84</sup>*Guidelines Concerning Registration and Operation of Specialized Imported Beef Stores*, Art. 5(A); *Regulations Concerning Sales of Imported Beef*, Art. 14(5); *Management Guideline for Imported Beef*, Art. 9(6).

<sup>85</sup> Apart from the display sign requirement, dealt with in para. 151.

<sup>86</sup> See Panel Report, para. 630.

Accordingly, the existing small retailers had to choose between, on the one hand, continuing to sell domestic beef and renouncing the sale of imported beef or, on the other hand, ceasing to sell domestic beef in order to be allowed to sell the imported product. Apparently, the vast majority of the small meat retailers chose the first option.<sup>87</sup> The result was the virtual exclusion of imported beef from the retail distribution channels through which domestic beef (and until then, imported beef, too) was distributed to Korean households and other consumers throughout the country. Accordingly, a new and separate retail system had to be established and gradually built from the ground up for bringing the imported product to the same households and other consumers if the imported product was to compete at all with the domestic product. Put in slightly different terms, the putting into legal effect of the dual retail system for beef meant, in direct practical effect, so far as imported beef was concerned, the sudden cutting off of access to the normal, that is, the previously existing, distribution outlets through which the domestic product continued to flow to consumers in the urban centers and countryside that make up the Korean national territory. The central consequence of the dual retail system can only be reasonably construed, in our view, as the imposition of a drastic reduction of commercial opportunity to reach, and hence to generate sales to, the same consumers served by the traditional retail channels for domestic beef. In 1998, when this case began, eight years after the dual retail system was first prescribed, the consequent reduction of commercial opportunity was reflected in the much smaller number of specialized imported beef shops (approximately 5,000 shops) as compared with the number of retailers (approximately 45,000 shops) selling domestic beef.<sup>88</sup>

146. We are aware that the dramatic reduction in number of retail outlets for imported beef followed from the decisions of individual retailers who could choose freely to sell the domestic product or the imported product. The legal necessity of making a choice was, however, imposed by the measure itself. The restricted nature of that choice should be noted. The choice given to the meat retailers was *not* an option between remaining with the pre-existing unified distribution set-up or going to a dual retail system. The choice was limited to selling domestic beef only or imported beef only. Thus, the reduction of access to normal retail channels is, in legal contemplation, the effect of that measure. In these circumstances, the intervention of some element of private choice does not relieve Korea of responsibility under the GATT 1994 for the resulting establishment of competitive conditions less favourable for the imported product than for the domestic product.

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<sup>87</sup> Panel Report, para. 633.

<sup>88</sup> The number of imported beef shops is noted by the Panel in footnote 347 of the Panel Report; the number of domestic beef shops has been provided by the United States in para. 175 of the Panel Report, and has not been contested by Korea.

147. We also note that the reduction of competitive opportunity through the restriction of access to consumers results from the imposition of the dual retail system for beef, notwithstanding the "perfect regulatory symmetry" of that system<sup>89</sup>, and is not a function of the limited volume of foreign beef actually imported into Korea. The fact that the WTO-consistent quota for beef has, save for two years, been fully utilized does not detract from the lack of equality of competitive conditions entailed by the dual retail system.

148. We believe, and so hold, that the treatment accorded to imported beef, as a consequence of the dual retail system established for beef by Korean law and regulation, is less favourable than the treatment given to like domestic beef and is, accordingly, not consistent with the requirements of Article III:4 of the GATT 1994.

149. It may finally be useful to indicate, however broadly, what we are *not* saying in reaching our above conclusion. We are *not* holding that a dual or parallel distribution system that is *not* imposed directly or indirectly by law or governmental regulation, but is rather solely the result of private entrepreneurs acting on their own calculations of comparative costs and benefits of differentiated distribution systems, is unlawful under Article III:4 of the GATT 1994. What is addressed by Article III:4 is merely the *governmental* intervention that affects the conditions under which like goods, domestic and imported, compete in the market within a Member's territory.

150. Finally, we note that Korea requires that imported beef be sold in a store displaying a sign declaring "Specialized Imported Beef Store". The Panel found that the sign requirement was "essentially ancillary to the dual retail system", and, since the dual retail system was inconsistent with Article III:4, the Panel found that the sign requirement was as well.<sup>90</sup> The Panel found also that, since the sign requirement went beyond an obligation to indicate origin, it was inconsistent with statements contained in a 1956 GATT Working Party Report.<sup>91</sup> On appeal, Korea claims that the Panel used "erroneous logic" in its conclusion based on the ancillary character of the sign requirement, and that the statement in the Working Party Report did not apply to the sign requirement.<sup>92</sup>

151. Without a system of specialized imported beef stores, the sign requirement would have no meaning and would not be required. When considered independently from a dual retail system, a sign

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<sup>89</sup>The notion of "perfect regulatory symmetry" is set out in Korea's appellant's submission, para. 95. See also *supra*, para. 17.

<sup>90</sup>Panel Report, para. 641.

<sup>91</sup>Working Party Report, *Certificates of Origin, Marks of Origin, Consular Formalities*, adopted 17 November 1956, BISD 5S/102, para. 13.

<sup>92</sup>Korea's appellant's submission, paras. 206-213.

requirement might or might not be characterized legally as consistent with Article III:4 of the GATT 1994. On the other hand, when considered simply as a detail of the dual retail system, the sign requirement partakes of the legal characterization given to that system itself. We believe it unnecessary to pass upon separately the consistency of the display sign requirement with Article III:4 of the GATT 1994.

#### B. Article XX(d) of the GATT 1994

152. The Panel went on to conclude that the dual retail system, which it found to be inconsistent with Article III:4, could *not* be justified pursuant to Article XX(d) of the GATT 1994. The Panel found that the dual retail system is a disproportionate measure not necessary to secure compliance with the Korean law against deceptive practices.<sup>93</sup>

153. The Panel began its examination of Korea's dual retail system under Article XX(d) by finding that the dual retail system was designed to "secure compliance" with the *Unfair Competition Act*, a law consistent on its face with WTO provisions.<sup>94</sup> The Panel then focused on whether the dual retail system is "necessary" to secure compliance with that law. It examined enforcement measures taken by Korea for related products where fraudulent misrepresentation or passing of one product for another has occurred, and found that in these areas a dual retail system was not used. Instead, in respect of such product areas, Korea uses traditional enforcement measures, consistent with WTO rules, which include record-keeping, investigations, policing and fines. The Panel next inquired into whether these alternative, WTO-consistent measures were "reasonably available" to Korea to meet Korea's desired level of enforcement of laws against fraudulent misrepresentation in the retail beef sector. The Panel concluded that these measures are "reasonably available" alternative measures, and that Korea therefore cannot justify the dual retail system as "necessary" under Article XX(d).<sup>95</sup>

154. Korea appeals the Panel's conclusion. Korea argues that the Panel incorrectly interpreted the term "necessary" in Article XX(d) as requiring *consistency* among enforcement measures taken in related product areas.<sup>96</sup> Further, according to Korea, the Panel neglected to take into account the *level of enforcement* that Korea sought with respect to preventing the fraudulent sale of imported beef.<sup>97</sup>

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<sup>93</sup>Panel Report, para. 675.

<sup>94</sup>*Ibid.*, para. 658.

<sup>95</sup>*Ibid.*, paras. 660-674.

<sup>96</sup>Korea's appellant's submission, paras. 166-180.

<sup>97</sup>*Ibid.*, paras. 181-193.

155. Article XX(d), together with the introductory clause of Article XX, reads as follows:

*Article XX*

*General Exceptions*

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 Member of measures:

...

(d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trade marks and copyrights, and the prevention of deceptive practices;

156. We note that in examining the Korean dual retail system under Article XX, the Panel followed the appropriate sequence of steps outlined in *United States – Standards for Reformulated and Conventional Gasoline* ("United States – Gasoline"). There we said:

In order that the justifying protection of Article XX may be extended to it, the measure at issue must not only come under one or another of the particular exceptions -- paragraphs (a) to (j) -- listed under Article XX; it must also satisfy the requirements imposed by the opening clauses of Article XX. *The analysis is, in other words, two-tiered: first, provisional justification by reason of characterization of the measure under XX(g); second, further appraisal of the same measure under the introductory clauses of Article XX.*<sup>98</sup> (emphasis added)

The Panel concentrated its analysis on paragraph (d), that is, the first-tier analysis. Having found that the dual retail system did not fulfill the requirements of paragraph (d), the Panel correctly considered that it did not need to proceed to the second-tier analysis, that is, to examine the application in this case of the requirements of the introductory clause of Article XX.

157. For a measure, otherwise inconsistent with GATT 1994, to be justified provisionally under paragraph (d) of Article XX, two elements must be shown. First, the measure must be one designed to "secure compliance" with laws or regulations that are not themselves inconsistent with some

<sup>98</sup>Appellate Body Report, WT/DS2/AB/R, adopted 20 May 1996, p. 22. See also, Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products* ("United States – Shrimp"), WT/DS58/AB/R, adopted 6 November 1998, paras. 119-121.

provision of the GATT 1994. Second, the measure must be "necessary" to secure such compliance. A Member who invokes Article XX(d) as a justification has the burden of demonstrating that these two requirements are met.<sup>99</sup>

158. The Panel examined these two aspects one after the other. The Panel found, "despite ... troublesome aspects, ... that the dual retail system was put in place, at least in part, in order to secure compliance with the Korean legislation against deceptive practices to the extent that it serves to prevent acts inconsistent with the *Unfair Competition Act*."<sup>100</sup> It recognized that the system was established at a time when acts of misrepresentation of origin were widespread in the beef sector. It also acknowledged that the dual retail system "does appear to reduce the opportunities and thus the temptations for butchers to misrepresent [less expensive] foreign beef for [more expensive] domestic beef".<sup>101</sup> The parties did not appeal these findings of the Panel.

159. We turn, therefore, to the question of whether the dual retail system is "necessary" to secure compliance with the *Unfair Competition Act*. Once again, we look first to the ordinary meaning of the word "necessary", in its context and in the light of the object and purpose of Article XX, in accordance with Article 31(1) of the *Vienna Convention*.

160. The word "necessary" normally denotes something "that cannot be dispensed with or done without, requisite, essential, needful".<sup>102</sup> We note, however, that a standard law dictionary cautions that:

[t]his word must be considered in the connection in which it is used, as it is a word susceptible of various meanings. It may import absolute physical necessity or inevitability, or it may import that which is only convenient, useful, appropriate, suitable, proper, or conducive to the end sought. It is an adjective expressing degrees, and may express mere convenience or that which is indispensable or an absolute physical necessity".<sup>103</sup>

<sup>99</sup>Appellate Body Report, *United States – Gasoline*, supra, footnote 98, pp. 22-23; Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R, adopted 23 May 1997, pp. 14-16; Panel report, *United States – Section 337*, supra, footnote 69, para. 5.27.

<sup>100</sup>Panel Report, para. 658.

<sup>101</sup>*Ibid*.

<sup>102</sup>*The New Shorter Oxford English Dictionary*, (Clarendon Press, 1993), Vol. II, p. 1895.

<sup>103</sup>*Black's Law Dictionary*, (West Publishing, 1995), p. 1029.

161. We believe that, as used in the context of Article XX(d), the reach of the word "necessary" is not limited to that which is "indispensable" or "of absolute necessity" or "inevitable". Measures which are indispensable or of absolute necessity or inevitable to secure compliance certainly fulfil the requirements of Article XX(d). But other measures, too, may fall within the ambit of this exception. As used in Article XX(d), the term "necessary" refers, in our view, to a range of degrees of necessity. At one end of this continuum lies "necessary" understood as "indispensable"; at the other end, is "necessary" taken to mean as "making a contribution to." We consider that a "necessary" measure is, in this continuum, located significantly closer to the pole of "indispensable" than to the opposite pole of simply "making a contribution to".<sup>104</sup>

162. In appraising the "necessity" of a measure in these terms, it is useful to bear in mind the context in which "necessary" is found in Article XX(d). The measure at stake has to be "necessary to ensure compliance with laws and regulations ... , including those relating to customs enforcement, the enforcement of [lawful] monopolies ... , the protection of patents, trade marks and copyrights, and the prevention of deceptive practices". (emphasis added) Clearly, Article XX(d) is susceptible of application in respect of a wide variety of "laws and regulations" to be enforced. It seems to us that a treaty interpreter assessing a measure claimed to be necessary to secure compliance of a WTO-consistent law or regulation may, in appropriate cases, take into account the relative importance of the common interests or values that the law or regulation to be enforced is intended to protect. The more vital or important those common interests or values are, the easier it would be to accept as "necessary" a measure designed as an enforcement instrument.

163. There are other aspects of the enforcement measure to be considered in evaluating that measure as "necessary". One is the extent to which the measure contributes to the realization of the end pursued, the securing of compliance with the law or regulation at issue. The greater the contribution, the more easily a measure might be considered to be "necessary". Another aspect is the extent to which the compliance measure produces restrictive effects on international commerce<sup>105</sup>, that is, in respect of a measure inconsistent with Article III:4, restrictive effects on *imported goods*.

<sup>104</sup>We recall that we have twice interpreted Article XX(g), which requires a measure "relating to the conservation of exhaustible natural resources". (emphasis added). This requirement is more flexible textually than the "necessity" requirement found in Article XX(d). We note that, under the more flexible "relating to" standard of Article XX(g), we accepted in *United States – Gasoline* a measure because it presented a "substantial relationship", (emphasis added) i.e., a close and genuine relationship of ends and means, with the conservation of clean air. *Supra*, footnote 98, p.19. In *United States – Shrimp* we accepted a measure because it was "reasonably related" to the protection and conservation of sea turtles. *Supra*, footnote 98, at para. 141.

<sup>105</sup>We recall that the last paragraph of the Preamble of the GATT of 1994 reads as follows: "Being desirous of contributing to these objectives by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce". (emphasis added)

A measure with a relatively slight impact upon imported products might more easily be considered as "necessary" than a measure with intense or broader restrictive effects.

164. In sum, determination of whether a measure, which is not "indispensable", may nevertheless be "necessary" within the contemplation of Article XX(d), involves in every case a process of weighing and balancing a series of factors which prominently include the contribution made by the compliance measure to the enforcement of the law or regulation at issue, the importance of the common interests or values protected by that law or regulation, and the accompanying impact of the law or regulation on imports or exports.

165. The panel in *United States – Section 337* described the applicable standard for evaluating whether a measure is "necessary" under Article XX(d) in the following terms:

It was clear to the Panel that a contracting party cannot justify a measure inconsistent with another GATT provision as "necessary" in terms of Article XX(d) if an alternative measure which it could reasonably be expected to employ and which is not inconsistent with other GATT provisions is available to it. By the same token, in cases where a measure consistent with other GATT provisions is not reasonably available, a contracting party is bound to use, among the measures reasonably available to it, that which entails the least degree of inconsistency with other GATT provisions.<sup>106</sup>

166. The standard described by the panel in *United States – Section 337* encapsulates the general considerations we have adverted to above. In our view, the weighing and balancing process we have outlined is comprehended in the determination of whether a WTO-consistent alternative measure which the Member concerned could "reasonably be expected to employ" is available, or whether a less WTO-inconsistent measure is "reasonably available".

167. The Panel followed the standard identified by the panel in *United States – Section 337*. It started scrutinizing whether the dual retail system is "necessary" under paragraph (d) of Article XX by stating:

Korea has to convince the Panel that, contrary to what was alleged by Australia and the United States, no alternative measure consistent with the WTO Agreement is reasonably available at present in order to deal with misrepresentation in the retail market as to the origin of beef.<sup>107</sup>

<sup>106</sup>Panel report, *United States – Section 337, supra*, footnote 69, para. 5.26.

<sup>107</sup>Panel Report, para. 659.

168. The Panel first considered a range of possible alternative measures, by examining measures taken by Korea with respect to situations involving, or which could involve, deceptive practices similar to those which in 1989-1990 had affected the retail sale of foreign beef. The Panel found that Korea does not require a dual retail system in *related product areas*, but relies instead on traditional enforcement procedures. There is no requirement, for example, for a dual retail system separating domestic Hanwoo beef from domestic dairy cattle beef.<sup>108</sup> Nor is there a requirement for a dual retail system for any other meat or food product, such as pork or seafood.<sup>109</sup> Finally, there is no requirement for a system of separate restaurants, depending on whether they serve domestic or imported beef, even though approximately 45 per cent of the beef imported into Korea is sold in restaurants.<sup>110</sup> Yet, in all of these cases, the Panel found that there were numerous cases of fraudulent misrepresentation.<sup>111</sup> For the Panel, these examples indicated that misrepresentation of origin could, in principle, be dealt with "on the basis of basic methods . . . such as normal policing under the Korean *Unfair Competition Act*."<sup>112</sup>

169. Korea argues, on appeal, that the Panel, by drawing conclusions from the absence of any requirement for a dual retail system in related product areas, introduces an illegitimate "consistency test" into Article XX(d). For Korea, the proper test for "necessary" under Article XX(d):

... is to see whether another means exists which is less restrictive than the one used and which can reach the objective sought. Whether such means will be applied *consistently* to other products or not is not a matter of concern for the necessity requirement under Article XX(d).<sup>113</sup>

170. Examining enforcement measures applicable to the same illegal behaviour relating to like, or at least similar, products does not necessarily imply the introduction of a "consistency" requirement into the "necessary" concept of Article XX(d). Examining such enforcement measures may provide useful input in the course of determining whether an alternative measure which could "reasonably be expected" to be utilized, is available or not.

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<sup>108</sup>In 1998, domestic dairy cattle beef amounted to 12 percent of total beef consumption in Korea. Panel Report, para. 661.

<sup>109</sup>*Ibid.*, para. 662.

<sup>110</sup>*Ibid.*, para. 663.

<sup>111</sup>*Ibid.*, paras. 661-663, including footnote 366, in which the Panel noted "that the Livestock Times reported that the deceptive beef marketing practice was widespread in restaurants (where price differential was 58 per cent)".

<sup>112</sup>*Ibid.*, para. 664.

<sup>113</sup>Korea's appellant's submission, para. 167.

171. The enforcement measures that the Panel examined were measures taken to enforce the same law, the *Unfair Competition Act*.<sup>114</sup> This law provides for penal and other sanctions<sup>115</sup> against any "unfair competitive act", which includes any:

*Act misleading the public to understand the place of origin of any goods either by falsely marking that place on any commercial document or in any manner of misleading the general public, or by thereof or in any manner of misleading the general public, or by selling, distributing, importing or exporting goods bearing such mark,*<sup>116</sup> (emphasis added)

The language used in this law to define an "unfair competitive act" – "any manner of misleading the general public" – is broad. It applies to all the examples raised by the Panel – domestic dairy beef sold as Hanwoo beef, foreign pork or seafood sold as domestic product, as well as to imported beef served as domestic beef in restaurants.

172. The application by a Member of WTO-compatible enforcement measures to the same kind of illegal behaviour – the passing off of one product for another – for like or at least similar products, provides a suggestive indication that an alternative measure which could "reasonably be expected" to be employed may well be available. The application of such measures for the control of the same illegal behaviour for like, or at least similar, products raises doubts with respect to the objective *necessity* of a different, much stricter, and WTO-inconsistent enforcement measure. The Panel was, in our opinion, entitled to consider that the "examples taken from outside as well as within the beef sector indicate that misrepresentation of origin can indeed be dealt with on the basis of basic methods, consistent with the *WTO Agreement*, and thus less trade restrictive and less market intrusive, such as normal policing under the Korean *Unfair Competition Act*."<sup>117</sup>

173. Having found that possible alternative enforcement measures, consistent with the *WTO Agreement*, existed in other related product areas, the Panel went on to state that:

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<sup>114</sup>In GATT case law, comparisons have been made between enforcement measures taken in different jurisdictions. In the *United States – Measures Affecting Alcoholic and Malt Beverages* case, the panel said that "[t]he fact that not all fifty states maintain discriminatory distribution systems indicates to the Panel that alternative measure for enforcement of state excise tax laws do indeed exist." Adopted 19 June 1992, BISD 39S/206, para. 5.43. In the *United States – Section 337* case, the panel "did not consider that a different scheme for imports alleged to infringe process patents is necessary, since many countries grant to their civil courts jurisdiction over imports of products manufactured abroad under processes protected by patents of the importing country". *Supra*, footnote 69, para. 5.28.

<sup>115</sup>*Unfair Competition Prevention and Business Secret Protection Act*, Article 2(1)(c), Article 8.

<sup>116</sup>*Unfair Competition Prevention and Business Secret Protection Act*, Article 2(1)(c) (from translation provided by Korea as Exhibit 28 of its second submission to the Panel).

<sup>117</sup>Panel Report, para. 664.

... it is for Korea to demonstrate that such an alternative measure is not reasonably available or is unreasonably burdensome, financially or technically, taking into account a variety of factors including the domestic costs of such alternative measure, to ensure that consumers are not misled as to the origin of beef.<sup>118</sup>

174. The Panel proceeded to examine whether the alternative measures or "basic methods" – investigations, prosecutions, fines, and record-keeping – which were used in related product areas, were "reasonably available" to Korea to secure compliance with the *Unfair Competition Act*. The Panel concluded "that Korea has not demonstrated to the satisfaction of the Panel that alternative measures consistent with the WTO Agreement were not reasonably available".<sup>119</sup> Thus, as noted at the outset, the Panel found that the dual retail system was "a disproportionate measure not necessary to secure compliance with the Korean law against deceptive practices".<sup>120</sup> The dual retail system was, therefore, not justified under Article XX(d).<sup>121</sup>

175. Korea also argues on appeal that the Panel erred in applying Article XX(d) because it did not "pay due attention to the level of enforcement sought."<sup>122</sup> For Korea, under Article XX(d), a panel must:

... examine whether a means reasonably available to the WTO Member could have been used in order to reach the objective sought without putting into question the level of enforcement sought.<sup>123</sup>

For Korea, alternative measures must not only be reasonably available, but must also *guarantee* the level of enforcement sought which, in the case of the dual retail system, is the *elimination* of fraud in the beef retail market.<sup>124</sup> With respect to investigations, Korea argues that this tool can only reveal fraud *ex post*, whereas the dual retail system can combat fraudulent practices *ex ante*.<sup>125</sup> Korea contends that *ex post* investigations do not *guarantee* the level of enforcement that Korea has chosen, and therefore should not be considered. With respect to policing, Korea believes that this option is not "reasonably available", because Korea lacks the resources to police thousands of shops on a round-the-clock basis.

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<sup>118</sup>Panel Report, para. 665.

<sup>119</sup>*Ibid.*, para. 674.

<sup>120</sup>*Ibid.*, para. 675.

<sup>121</sup>*Ibid.*

<sup>122</sup>Korea's appellant's submission, para. 182.

<sup>123</sup>*Ibid.*, para. 181.

<sup>124</sup>*Ibid.*, paras. 181, 185.

<sup>125</sup>*Ibid.*, para. 192.

176. It is not open to doubt that Members of the WTO have the right to determine for themselves the level of enforcement of their WTO-consistent laws and regulations. We note that this has also been recognized by the panel in *United States – Section 337*, where it said: "The Panel wished to make it clear that this [the obligation to choose a reasonably available GATT-consistent or less inconsistent measure] does not mean that a contracting party could be asked to change its substantive patent law or its desired *level of enforcement* of that law ...." (emphasis added) The panel added, however, the caveat that "provided that such law and such *level of enforcement* are the same for imported and domestically-produced products".<sup>126</sup>

177. We recognize that, in establishing the dual retail system, Korea could well have intended to secure a higher level of enforcement of the prohibition, provided by the *Unfair Competition Act*, of acts misleading the public *about the origin of beef* (domestic or imported) *sold by retailers*, than the level of enforcement of the same prohibition of the *Unfair Competition Act* with respect to *beef served in restaurants*, or the sale by *retailers of other meat or food products*, such as *pork or seafood*.

178. We think it unlikely that Korea intended to establish a level of protection that *totally eliminates* fraud with respect to the origin of beef (domestic or foreign) sold by retailers. The total elimination of fraud would probably require a total ban of imports. Consequently, we assume that in effect Korea intended to *reduce considerably* the number of cases of fraud occurring with respect to the origin of beef sold by retailers. The Panel did find that the dual retail system "does appear to reduce the opportunities and thus the temptations for butchers to misrepresent foreign beef for domestic beef".<sup>127</sup> And we accept Korea's argument that the dual retail system *facilitates* control and permits combatting fraudulent practices *ex ante*. Nevertheless, it must be noted that the dual retail system is only an *instrument* to achieve a significant reduction of violations of the *Unfair Competition Act*. Therefore, the question remains whether other, conventional and WTO-consistent instruments can not reasonably be expected to be employed to achieve the same result.

179. Turning to investigations, the Panel found that Korea, in the past, had been able to distinguish imported beef from domestic beef, and had, in fact, published figures on the amount of imported beef fraudulently sold as domestic beef. This meant that Korea was able, in fact, to detect fraud.<sup>128</sup> On fines, the Panel found that these could be an effective deterrent, as long as they outweighed the

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<sup>126</sup>Panel report, *United States – Section 337, supra*, footnote 69, para. 5.26.

<sup>127</sup>Panel Report, para. 658.

<sup>128</sup>*Ibid.*, para. 668.

potential profits from fraud.<sup>129</sup> On record-keeping, the Panel felt that if beef traders at all levels were required to keep records of their transactions, then effective investigations could be carried out.<sup>130</sup> Finally, on policing, the Panel noted that Korea had not demonstrated that the costs would be too high.<sup>131</sup> For all these reasons, the Panel considered "that Korea has not demonstrated to the satisfaction of the Panel that alternative measures consistent with the WTO Agreement were not reasonably available".<sup>132</sup> Thus, as already noted, the Panel found that the dual retail system was "a disproportionate measure not necessary to secure compliance with the Korean law against deceptive practices".<sup>133</sup>

180. We share the Panel's conclusion. We are not persuaded that Korea could not achieve its desired level of enforcement of the *Unfair Competition Act* with respect to the origin of beef sold by retailers by using conventional WTO-consistent enforcement measures, if Korea would devote more resources to its enforcement efforts on the beef sector. It might also be added that Korea's argument about the lack of resources to police thousands of shops on a round-the-clock basis is, in the end, not sufficiently persuasive. Violations of laws and regulations like the Korean *Unfair Competition Act* can be expected to be routinely investigated and detected through selective, but well-targeted, controls of potential wrongdoers. The control of records will assist in selecting the shops to which the police could pay particular attention.

181. There is still another aspect that should be noted relating to both the method actually chosen by Korea – its dual retail system for beef – and alternative traditional enforcement measures. Securing through conventional, WTO-consistent measures a higher level of enforcement of the *Unfair Competition Act* with respect to the retail sale of beef, could well entail higher enforcement costs for the national budget. It is pertinent to observe that, through its dual retail system, Korea has in effect shifted all, or the great bulk, of these potential costs of enforcement (translated into a drastic reduction of competitive access to consumers) to imported goods and retailers of imported goods, instead of evenly distributing such costs between the domestic and imported products. In contrast, the more conventional, WTO-consistent measures of enforcement do not involve such onerous shifting of enforcement costs which ordinarily are borne by the Member's public purse.

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<sup>129</sup>Panel Report, para. 669

<sup>130</sup>*Ibid.*, para. 672.

<sup>131</sup>*Ibid.*, para. 673.

<sup>132</sup>*Ibid.*, para. 674.

<sup>133</sup>*Ibid.*, para. 675.

182. For these reasons, we uphold the conclusion of the Panel that Korea has not discharged its burden of demonstrating under Article XX(d) that alternative WTO-consistent measures were not "reasonably available" in order to detect and suppress deceptive practices in the beef retail sector<sup>134</sup>, and that the dual retail system is therefore not justified by Article XX(d).<sup>135</sup>

183. Korea further argues, on appeal, that the Panel did not make a separate finding on whether the display sign requirement was justified by Article XX(d), and requests that, should the Appellate Body uphold the Panel's finding that the sign requirement was inconsistent with Article III:4, it should proceed to consider the issue of its justification under Article XX(d).<sup>136</sup>

184. We recall that Korean law requires an imported beef retailer to display a sign reading "Specialized Imported Beef Store".<sup>137</sup> Since the Panel correctly regarded the sign requirement as merely ancillary to the dual retail system, we consider that it is unnecessary to examine separately whether the display sign requirement can be justified under Article XX(d).

185. In sum, we uphold the Panel's conclusion that the dual retail system, which is inconsistent with Article III:4, is not justified under Article XX(d) of the GATT 1994.

## VII. Findings and Conclusions

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

- (a) upholds the Panel's conclusion that, under the Panel's terms of reference, the Panel was required to examine, pursuant to the complaining parties' claims, the commitment levels in Korea's Schedule and Annex 3 of the *Agreement on Agriculture*;
- (b) upholds the Panel's conclusion that Korea's domestic support for beef for 1997 and 1998 was not correctly calculated pursuant to Article 1(a)(ii) and Annex 3 of the *Agreement on Agriculture*;
- (c) reverses the Panel's finding on recalculated amounts of Korea's domestic support for beef in 1997 and 1998, as the Panel used, for these recalculations, a methodology inconsistent with Article 1(a)(ii) and Annex 3 of the *Agreement on Agriculture*; and

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<sup>134</sup>Panel Report, para. 674.

<sup>135</sup>*Ibid.*, para. 675.

<sup>136</sup>Korea's appellant's submission, paras. 217-223.

<sup>137</sup>Panel Report, paras. 642-643.

reverses, therefore, the Panel's following conclusions, based on these recalculated amounts: (i) that Korea's domestic support for beef in 1997 and 1998 exceeded the *de minimis* level contrary to Article 6 of the *Agreement on Agriculture*; (ii) that Korea's failure to include Current AMS for beef in Korea's Current Total AMS was contrary to Article 7.2(a) of that Agreement; and (iii) that Korea's total domestic support for 1997 and 1998 exceeded Korea's commitment levels contrary to Article 3.2 of the *Agreement on Agriculture*;

(d) is unable, in view of the insufficient factual findings made by the Panel, to complete the legal analysis of: (i) whether Korea's domestic support for beef exceeds the *de minimis* level contrary to Article 6 of the *Agreement on Agriculture*; (ii) whether the failure to include Current AMS for beef in Korea's Current Total AMS was contrary to Article 7.2(a) of that Agreement; and (iii) whether Korea's total domestic support for 1997 and 1998 exceeded Korea's commitment levels contrary to Article 3.2 of the *Agreement on Agriculture*;

(e) upholds the Panel's ultimate conclusion that Korea's dual retail system for beef is inconsistent with Article III:4 of the GATT 1994;

(f) upholds the Panel's conclusion that Korea's dual retail system for beef is not justified under Article XX(d) of the GATT 1994; and

(g) finds it unnecessary to pass upon separately whether the ancillary sign requirement is consistent with Article III:4 or justified under Article XX(d) of the GATT 1994.

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

Signed in the original at Geneva this 2nd day of December 2000 by:

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Claus-Dieter Ehlermann  
Presiding Member

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Florentino P. Feliciano  
Member

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Georges-Michel Abi-Saab  
Member



**World Trade Organization**

**European Communities – Measures affecting Asbestos and  
Asbestos-Containing Products**

**Report of the Appellate Body, 12 March 2001**

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**EUROPEAN COMMUNITIES – MEASURES AFFECTING ASBESTOS  
AND ASBESTOS-CONTAINING PRODUCTS**

AB-2000-11

*Report of the Appellate Body*

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WORLD TRADE ORGANIZATION  
APPELLATE BODY

**European Communities – Measures  
Affecting Asbestos and Asbestos-Containing  
Products**

AB-2000-11

Present:

Feliciano, Presiding Member  
Bacchus, Member  
Ehlermann, Member

Canada, *Appellanti/Appellee*  
European Communities, *Appellant/Appellee*

Brazil, *Third Participant*  
United States, *Third Participant*

**I. Introduction**

1. Canada appeals certain issues of law and legal interpretations developed in the Panel Report in *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products* (the "Panel Report").<sup>1</sup> The Panel was established to consider claims made by Canada regarding French Decree No. 96-1133 concerning asbestos and products containing asbestos (*décret no. 96-1133 relatif à l'interdiction de l'amiante, pris en application du code de travail et du code de la consommation*) ("the Decree"), which entered into force on 1 January 1997.<sup>2</sup>

2. Articles 1 and 2 of the Decree set forth prohibitions on asbestos and on products containing asbestos fibres, followed by certain limited and temporary exceptions from those prohibitions:

**Article 1**

I. For the purpose of protecting workers, and pursuant to Article L. 231-7 of the Labour Code, the manufacture, processing, sale, import, placing on the domestic market and transfer under any title whatsoever of all varieties of asbestos fibres shall be prohibited, regardless of whether these substances have been incorporated into materials, products or devices.

<sup>1</sup>WT/DS135/R, 18 September 2000.

<sup>2</sup>*Journal officiel*, 26 December 1996.

II. For the purpose of protecting consumers, and pursuant to Article L. 221.3 of the Consumer Code, the manufacture, import, domestic marketing, exportation, possession for sale, offer, sale and transfer under any title whatsoever of all varieties of asbestos fibres or any product containing asbestos fibres shall be prohibited.

III. The bans instituted under Articles I and II shall not prevent fulfilment of the obligations arising from legislation on the elimination of wastes.

#### Article 2

I. On an exceptional and temporary basis, the bans instituted under Article 1 shall not apply to certain existing materials, products or devices containing chrysotile fibre when, to perform an equivalent function, no substitute for that fibre is available which:

- On the one hand, in the present state of scientific knowledge, poses a lesser occupational health risk than chrysotile fibre to workers handling those materials, products or devices;
- on the other, provides all technical guarantees of safety corresponding to the ultimate purpose of the use thereof.

II. The scope of application of paragraph I of this Article shall cover only the materials, products or devices falling within the categories shown in an exhaustive list decreed by the Ministers for Labour, Consumption, the Environment, Industry, Agriculture and Transport. To ascertain the justification for maintaining these exceptions, the list shall be re-examined on an annual basis, after which the Senior Council for the Prevention of Occupational Hazards and the National Commission for Occupational Health and Safety in Agriculture shall be consulted.

The remaining operative provisions of the Decree contain additional rules governing the grant of an exception (Articles 3 and 4), the imposition of penalties for violation of the prohibition in Article 1 (Article 5), and the temporary exclusion of certain "vehicles" and "agricultural and forestry machinery" from aspects of the prohibition (Article 7). Further factual aspects of this dispute are set forth in paragraphs 2.1 – 2.7 of the Panel Report, and the Decree is reproduced in its entirety as Annex I in the Addendum to the Panel Report.<sup>3</sup>

3. Canada claimed that the Decree is inconsistent with a number of obligations of the European Communities under Article 2 of the *Agreement on Technical Barriers to Trade* (the "TBT Agreement"), Articles III and XI of the *General Agreement on Tariffs and Trade 1994* (the "GATT 1994"), and that, under Article XXIII:1(b) of the GATT 1994, the Decree nullified or

<sup>3</sup>WT/DS135/R/Add.1, pp. 3-6.

impaired advantages accruing to Canada directly or indirectly under the *Marrakesh Agreement Establishing the World Trade Organization* (the "*WTO Agreement*"), or impeded the attainment of an objective of that Agreement.<sup>4</sup>

4. In the Panel Report, circulated to WTO Members on 18 September 2000, the Panel concluded that:

- (a) ... the "prohibition" part of the Decree does not fall within the scope of the TBT Agreement. The part of the Decree relating to "exceptions" does fall within the scope of the TBT Agreement. However, as Canada has not made any claim concerning the compatibility with the TBT Agreement of the part of the Decree relating to exceptions, the Panel refrains from reaching any conclusion with regard to the latter.
- (b) ... chrysotile asbestos fibres as such and fibres that can be substituted for them as such are like products within the meaning of Article III:4 of the GATT 1994. Similarly, the Panel concludes that the asbestos-cement products and the fibro-cement products for which sufficient information has been submitted to the Panel are like products within the meaning of Article III:4 of the GATT 1994.
- (c) With respect to the products found to be like, the Panel concludes that the Decree violates Article III:4 of the GATT 1994.
- (d) However, ... the Decree, insofar as it introduces a treatment of these products that is discriminatory under Article III:4, is justified as such and in its implementation by the provisions of paragraph (b) and the introductory clause of Article XX of the GATT 1994.
- (e) Finally, ... Canada has not established that it suffered non-violation nullification or impairment of a benefit within the meaning of Article XXIII:1(b) of the GATT 1994.<sup>5</sup>

5. Having found that the Decree is subject to, and inconsistent with, the obligations set forth in Article III:4 of the GATT 1994, the Panel did not deem it necessary to examine the claims of Canada under Article XI of the GATT 1994.<sup>6</sup>

<sup>4</sup>Panel Report, paras. 1.1 and 1.2. In its request for the establishment of a panel (WT/DS135/3, 9 October 1998), Canada also claimed that the Decree is inconsistent with the obligations of the European Communities under Articles 2 and 5 of the *Agreement on the Application of Sanitary and Phytosanitary Measures* (the "*SPS Agreement*"). However, Canada did not pursue this claim in its written or oral arguments before the Panel.

<sup>5</sup>Panel Report, para. 9.1.

<sup>6</sup>*Ibid.*, para. 8.159.

6. On 23 October 2000, Canada notified the Dispute Settlement Body (the "DSB") of its decision to appeal certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel, pursuant to Article 16.4 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), and filed a Notice of Appeal with the Appellate Body pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "*Working Procedures*").<sup>7</sup> On 16 November 2000, Canada filed an appellant's submission.<sup>8</sup> On 21 November 2000, the European Communities filed an other appellant's submission.<sup>9</sup> On 1 December 2000, Canada and the European Communities each filed an appellee's submission.<sup>10</sup> On the same day, Brazil and the United States each filed a third participant's submission.<sup>11</sup>

7. On 21 November 2000, the Appellate Body received a letter from Zimbabwe indicating its interest in attending the oral hearing in this appeal. Zimbabwe participated in the proceedings before the Panel as a third party which had notified its interest to the DSB under Article 10.2 of the DSU, but it did not file a third participant's submission in the appeal. No participant or third participant objected to Zimbabwe's request. On 15 December 2000, the Members of the Division hearing this appeal informed Zimbabwe, the participants and third participants, that Zimbabwe would be allowed to attend the oral hearing as a passive observer.

8. On 20 December 2000, the Appellate Body informed the DSB that, due to the exceptional workload of the Appellate Body, and in light of the agreement of the participants, Canada and the European Communities, the Appellate Body Report in this appeal would be circulated to WTO Members no later than Monday, 12 March 2001.<sup>12</sup>

9. The oral hearing in the appeal was held on 17 and 18 January 2001.<sup>13</sup> The participants and the third participants presented oral arguments and responded to questions put to them by Members of the Division hearing the appeal.

## II. Arguments of the Participants and the Third Participants

### A. *Claims of Error by Canada – Appellant*

#### 1. *TBT Agreement*

10. Canada requests that the Appellate Body reverse the Panel's findings and conclusions on the definition of the term "technical regulation", hold that the Decree as a whole falls within the scope of the *TBT Agreement*, and find that the Decree is inconsistent with paragraphs 1, 2, 4 and 8 of Article 2 of the *TBT Agreement*.

11. Canada asserts that the Panel erred in law in failing to examine Canada's allegations under the *TBT Agreement*. The Panel wrongly split the Decree into two and considered the prohibitions and exceptions in the Decree to be separate measures for the purposes of determining whether the Decree is a technical regulation within the meaning of the *TBT Agreement*. Canada believes that the Panel's analysis is arbitrary, contrary to the internal coherence of the Decree, and allows the applicability of the *TBT Agreement* to be determined by the way in which a Member drafts its legislation.

12. Canada argues that the Panel also erred in its interpretation of the definition of "technical regulation" in Annex 1 to the *TBT Agreement*, in particular, in articulating two criteria that must be satisfied before a measure can be a "technical regulation": (i) the measure must concern identifiable products; and (ii) the measure must identify the technical characteristics that products must have to be marketed in the territory of the Member taking the measure. This interpretation adds requirements to the definition of "technical regulation" that have no basis in the text of the *TBT Agreement*, and are inconsistent with the object and purpose of that Agreement, namely to restrain non-tariff barriers to trade that may be disguised as technical regulations. In addition, with respect to the first criterion, requiring a measure to relate to identifiable products to constitute a technical regulation could lead to arbitrary results in practice. As for the second criterion, Canada alleges that it is too narrow and would exclude from characterization as "technical regulations", and thereby insulate from the disciplines of the *TBT Agreement*, measures regulating activities other than the marketing of products, such as measures relating to transportation of products, disposal of hazardous waste, and use of special equipment to repair certain products.

13. Canada challenges the Panel's conclusion that the *TBT Agreement* does not apply to a general prohibition like the one in the Decree. The Panel relied on a false distinction between general prohibitions, which it considered fall exclusively under the GATT 1994, and technical regulations, which are subject to the disciplines of the *TBT Agreement*. In fact, a technical regulation can have the effect on trade of a general prohibition.

<sup>7</sup>WT/DS135/8, 23 October 2000.

<sup>8</sup>Pursuant to Rule 21(1) of the *Working Procedures*.

<sup>9</sup>Pursuant to Rule 23(1) of the *Working Procedures*.

<sup>10</sup>Pursuant to Rules 22 and 23(3) of the *Working Procedures*.

<sup>11</sup>Pursuant to Rule 24 of the *Working Procedures*.

<sup>12</sup>WT/DS135/10, 20 December 2000.

<sup>13</sup>Pursuant to Rule 27 of the *Working Procedures*.

14. Canada maintains that, had the Panel viewed the Decree as a unified measure, and correctly interpreted the term "technical regulation", the Panel would have concluded that the Decree is a technical regulation within the meaning of the *TBT Agreement*. However, even if the general prohibition contained in the Decree were not characterized as a technical regulation, the Panel nevertheless erred in failing to examine Canada's claims under the *TBT Agreement*, given that the Panel also found that the *TBT Agreement* applies to the part of the Decree concerning exceptions, and that Canada's claims related to the Decree as a whole. Canada therefore requests the Appellate Body to reverse the Panel's conclusions on the applicability of the *TBT Agreement* to the Decree, and to assess the compatibility of the Decree with that Agreement. Canada argues that, as in *United States – Import Prohibition of Certain Shrimp and Shrimp Products* ("*United States – Shrimp*"), "the facts on the record of the panel proceedings" allow the Appellate Body "to undertake the completion of the analysis required to resolve this dispute."<sup>14</sup>

15. Canada argues that the Decree is inconsistent with Article 2.1 of the *TBT Agreement*. Since the principle of national treatment in Article 2.1 is a specific, particular expression of Article III:4 of the GATT 1994, the interpretation of the words "like products" in Article 2.1 must be identical to the interpretation of the same words in Article III:4. The meaning of "like products" in Article III:4 is relevant context and, in the view of Canada, both Article III:4 of the GATT 1994 and Article 2.1 of the *TBT Agreement* have the same object and purpose, namely to avoid protectionism and to provide equality of competitive conditions for imported products in relation to domestic products. Thus, Canada maintains, the findings of "likeness", and of less favourable treatment, made by the Panel pursuant to Article III:4 of the GATT 1994 must be extended to Article 2.1 of the *TBT Agreement*.

16. In Canada's view, the Decree is inconsistent with Article 2.2 of the *TBT Agreement*. Canada insists, first, that there is no rational connection between the Decree and France's objective of protecting human health since: (i) it is friable materials containing amphiboles which pose a risk to human health; (ii) the manipulation of chrysotile-cement products and other high-density products containing chrysotile asbestos fibres does not pose a danger to human health; and (iii) the Decree exposes the French public to substitute fibres, the health risks of which are still poorly understood. Canada adds, second, that the Decree has effects that are more trade-restrictive than necessary to achieve its objective, in particular, because: (i) the manipulation of chrysotile-cement products and other high-density products containing chrysotile asbestos fibres does not create a risk to human health, and (ii) there is a less trade-restrictive alternative that protects human health, namely the "controlled use" of chrysotile-cement products and other high-density products containing chrysotile asbestos fibres. What must be demonstrated under Article 2.2 of the *TBT Agreement* is the same as

<sup>14</sup> Appellate Body Report, WT/DS58/AB/R, adopted 6 November 1998, para. 124.

what must be demonstrated under Article XX(b) of the GATT 1994. In this regard, according to Canada, the reports of the panel and the Appellate Body in *United States – Standards for Reformulated and Conventional Gasoline* ("*United States – Gasoline*") establish that a less trade-restrictive alternative can only be ruled out if it is shown to be impossible to implement.<sup>15</sup> However, France did not demonstrate, and the Panel did not find, that it is impossible to implement "controlled use". Furthermore, Canada contends, it would be less trade-restrictive to ban products containing chrysotile asbestos fibres on the basis of a product-by-product demonstration of the ineffectiveness and unfeasibility of "controlled use", rather than on the basis of the existence of substitute products.

17. Canada also argues that the Decree is inconsistent with Article 2.4 of the *TBT Agreement*, because there are relevant international standards on the "controlled use" of chrysotile, which constitute an effective and appropriate means to achieve France's objective of protecting human health. In any event, the French government acted inconsistently with Article 2.4 because it did not use international standards as a basis for the Decree. Lastly, Canada considers that the Decree is inconsistent with Article 2.8 of the *TBT Agreement* because it institutes a prohibition based on the descriptive characteristics of products, rather than on requirements in terms of performance.

2. Article XX(b) of the GATT 1994 and Article 11 of the DSU

18. Canada requests that the Appellate Body reverse the Panel's findings and conclusions under Article XX(b) of the GATT 1994 and find that the Decree is not justified under that provision. Canada also asks the Appellate Body to find that the Panel did not make an "objective assessment of the matter", as required under Article 11 of the DSU, because it failed to assess the scientific data in accordance with the principle of the balance of probabilities, and failed to assess the facts objectively.

19. Canada argues that the Panel erred in finding that there is a risk to human health associated with the manipulation of chrysotile-cement products. Canada identifies seven factors it claims the Panel mistakenly relied on in reaching this conclusion: (i) a statement by Dr. Henderson that "building workers now count among those most exposed to chrysotile fibres and hence to the risk of mesothelioma"<sup>16</sup>; (ii) an "anecdotal" statement by Dr. Henderson concerning "cases of mesothelioma in patients who had been only incidentally exposed, without any relation to their occupational activity"<sup>17</sup>; (iii) the opinion of experts that it has not been established that there is a

<sup>15</sup> Panel Report, WT/DS2/R, adopted 20 May 1996, as modified by the Appellate Body Report, WT/DS2/AB/R, DSR 1996:1, 29.

<sup>16</sup> Panel Report, para. 8.191.

<sup>17</sup> *Ibid.*, para. 8.191 and footnote 147.

threshold below which exposure does not constitute a risk for mesothelioma or lung cancer; (iv) the "Charleston study"<sup>18</sup>; (v) "statistical data" adduced by Dr. Henderson, which, according to the Panel, confirmed "the impact of chrysotile on mechanics exposed to that material in a car brake maintenance context" despite a contrary study on automobile brake maintenance relied on by Canada<sup>19</sup>; (vi) the use of the no-threshold linear relationship model as a basis for concluding that there is a "real risk" and "an undeniable public health risk" associated with exposure to chrysotile asbestos fibres at low or intermittent levels<sup>20</sup>; and (vii) data supplied by the European Communities concerning intermittent manipulation and a reference by Dr. Henderson to a Japanese study as a basis for concluding that the manipulation of chrysotile-cement using inappropriate tools could cause exposure levels above statutory limits.<sup>21</sup> Canada sets forth detailed explanations as to why none of these factors supports the Panel's conclusion.

20. Canada also contends that the Panel erred in its application of the test of "necessity" under Article XX(b) of the GATT 1994. Canada accepts the Panel's view that the extent of the risk to human health is relevant to the assessment of "necessity". However, Canada disputes that there is any risk involved in the manipulation of such products, highlights that the evidence relied on by the Panel certainly could not form the basis for a finding that the health risk was so high that it could justify strict measures, and argues that the Panel failed to comply with its obligation to quantify this type of risk. In Canada's view, these errors distorted the Panel's analysis of the test of necessity and led it to take a much too restrictive approach to its consideration of reasonably available alternatives to the Decree.

21. Canada asserts that, in its examination of whether less restrictive international trade alternatives can achieve the level of protection inherent in the Decree, the Panel erred in accepting that such level of protection is a halt to the spread of the risk associated with chrysotile asbestos fibres. This premise does not take account of the risk associated with the use of substitute fibres, of the absence in France of any regulatory framework for "controlled use" of such fibres, or of the false sense of security created among the French public due to the absence of such a framework. The Panel also erred in law in finding that there was no reasonably available alternative to the Decree that is consistent or less inconsistent with the GATT 1994. In this regard, Canada makes the same arguments that it made above with respect to Article 2.2 of the *TBT Agreement*, and emphasizes that the Panel was overly strict in its examination of the alternatives, considering that France could have

<sup>18</sup>Panel Report, paras. 8.192 and 8.193.

<sup>19</sup>*Ibid.*, para. 8.192 and footnote 154.

<sup>20</sup>*Ibid.*, paras. 8.202 and 8.203.

<sup>21</sup>*Ibid.*, para. 8.191.

adopted a measure establishing bans on specific products containing chrysotile asbestos fibres, based on demonstrations of the ineffectiveness and unfeasibility of the "controlled use" of each product.

22. Canada submits that the Panel failed to discharge its responsibility to make an objective assessment of the matter when it declined to take a position on the opinions expressed by the scientific community. For Canada, the principle of the balance of probabilities, or the preponderance of evidence, requires the trier of fact to take a position as to the respective weight of the evidence. Had the Panel properly applied this principle, it would not have been able to conclude that the Decree was justified under Article XX(b) of the GATT 1994, in view of the multiple studies submitted by Canada showing, for example, that there is no increased risk among garage and brake mechanics, or among construction workers, resulting from the manipulation of chrysotile asbestos. Canada adds that the Panel also failed to make an objective assessment of the matter before it because, in its determinations on the "controlled use" of chrysotile, it relied extensively on the opinions of the experts consulted, who in fact did not possess expertise in the area of "controlled use".

B. *Arguments of the European Communities – Appellee*

1. *TBT Agreement*

23. The European Communities urges the Appellate Body to reject Canada's appeal on the *TBT Agreement*. The Panel correctly concluded that the "prohibition part" of the Decree is not a technical regulation within the meaning of Annex 1.1 to the *TBT Agreement*. Canada's arguments with respect to the "exceptions part" of the Decree are legally irrelevant, since it would be impossible for the Appellate Body to complete the legal analysis due to the lack of sufficient and undisputed facts. The European Communities adds that the claims made by Canada under the *TBT Agreement* should, in any event, be denied.

24. The European Communities sees no error in the Panel's separation of the prohibitions part of the Decree from the exceptions part. The exceptions are ancillary to the prohibitions, and separating the two parts for the purpose of their legal characterization under the *TBT Agreement* in no way affects the internal coherence of the Decree. In this case, the issue before the Panel was whether the prohibitions laid down in the Decree constitute a technical regulation, *not* whether, in the abstract, a general ban may be a technical regulation. The European Communities also considers that the Panel correctly interpreted the term "technical regulation", and that the interpretation suggested by Canada would deprive other GATT 1994 provisions, such as Article XI, of effect.

25. The European Communities agrees with the Panel's treatment of the exceptions part of the Decree, and insists that, having made no specific violation claim regarding the narrowness of the

exceptions throughout these proceedings, Canada cannot now argue that the exceptions violate the *TBT Agreement*. The European Communities argues that the Appellate Body is in any case prevented from addressing Canada's claims under the *TBT Agreement* because to do so would require the Appellate Body to make findings of a factual and technical nature which, in the absence of undisputed facts and findings in the record, it cannot do on appeal. The Appellate Body could not simply use the findings of the Panel under Articles III:4 and XX of the GATT 1994 as a basis for an analysis under the *TBT Agreement*. While the two sets of rules are related, they are not "part of a logical continuum"<sup>22</sup>, and are not sufficiently closely related as to allow the Appellate Body to extrapolate the findings of the Panel under Article III:4 and Article XX(b) of the GATT 1994 into the sphere of the *TBT Agreement*. Should the Appellate Body examine Canada's claims under the *TBT Agreement*, the European Communities argues that these claims should be dismissed and refers, in this regard, to its arguments with respect to Article XX(b) of the GATT 1994, and to the arguments it made before the Panel with regard to Articles 2.1, 2.2, 2.4 and 2.8 of the *TBT Agreement*.

2. Article XX(b) of the GATT 1994 and Article 11 of the DSU

26. The European Communities submits that the Panel's finding that the violation of Article III:4 is justified under Article XX(b) of the GATT 1994 is legally sound and correct. Canada's arguments on this issue amount to a request that the Appellate Body make new factual and scientific findings on appeal, contrary to the limits on the scope of appellate review set out in Article 17.6 of the DSU.

27. The European Communities believes that the Panel concluded that the ban on asbestos was "necessary" based on a series of objective and verifiable findings, made after a detailed and careful evaluation of the factual and scientific evidence presented. In assessing whether the ban was "necessary", the Panel was not obliged to undertake a "quantitative" assessment of the identified risk. Neither the ordinary meaning of the terms "necessary to protect" in Article XX(b) nor the concept of risk assessment mandate such an approach. An assessment of risk may be made either in quantitative or qualitative terms. The European Communities adds that the Panel correctly found that, after the European Communities had established a *prima facie* case for the existence of a health risk in connection with the use of chrysotile, Canada bore the burden of refuting that case by showing the absence of such a health risk.

28. On the issue of whether another measure was reasonably available, the European Communities submits that Canada cannot, on appeal, make arguments based on the health risks associated with the substitute products for asbestos, or on the safety of the "controlled use" of

asbestos, as both arguments seek to have the Appellate Body revisit factual findings made by the Panel on the basis of the evidence submitted and the opinions advanced by the experts consulted.

29. With respect to the alleged inconsistency with Article 11 of the DSU, the European Communities considers that Canada's claim that the Panel committed a fundamental error in its appreciation of the facts seems to be based solely on the fact that the Panel based itself exclusively on the opinions of the experts consulted in this case. In this regard, the European Communities emphasizes that Canada did not object to the selection of the experts by the Panel, that Canada proposed one of those experts itself, and that the experts themselves answered a question on "controlled use" rather than professing a lack of expertise on the issue. As for Canada's argument that the Panel erred in law in failing to evaluate the scientific evidence in accordance with the principle of preponderance of the evidence, the Panel's approach does not seem inconsistent with such a principle and, in any case, the principle of preponderance of the evidence is inapposite in the context of risk assessment since such an approach would preclude Members from basing their regulatory decisions on diverging scientific opinions. The European Communities refuses to accept that the evidence relied on by the Panel – representing the unanimous views of the four experts consulted and of all international institutions that have evaluated asbestos – reflects, as Canada seems to suggest, a divergent, minority scientific point of view on asbestos.

C. *Claims of Error by the European Communities – Appellant*

1. "Like Products" in Article III:4 of the GATT 1994

30. The European Communities requests the Appellate Body to reverse the Panel's findings that chrysotile asbestos fibres are "like" polyvinyl alcohol ("PVA"), cellulose and glass fibres, and that chrysotile-cement products are "like" fibro-cement products, as well as the Panel's consequent finding that, with respect to the products found to be "like", the Decree violates Article III:4 of the GATT 1994.

31. The Panel's interpretation of the term "like products" in Article III:4, is of serious concern to the European Communities; is contrary to the ordinary meaning of Article III:4, read in context and in light of its object and purpose; and is inconsistent with established case law. As the Appellate Body has previously found, the first paragraph of Article III defines the object and purpose of the whole of Article III, namely, to provide equality of competitive conditions for imported products in relation to domestic products. In the view of the European Communities, the Panel, however, erroneously analyzed the term "like products" in light of the objective of ensuring market access for products, and, in so doing, adopted an exclusively commercial approach to the comparison of "like" products and erroneously expanded the scope of application of Article III:4.

<sup>22</sup>European Communities' appellee's submission, para. 43.

32. The European Communities submits that this erroneous focus on market access led the Panel to exclude from its "like" product analysis the very reason why the Decree singles out asbestos fibres, namely, the fact that asbestos fibres are carcinogenic. While Article III:4 protects expectations concerning the competitive relationship between imported and domestic products, the impact of a measure on such expectations is not relevant in determining "likeness", but only later in the Article III:4 analysis, for the purposes of establishing whether the measure discriminates between imported and domestic products. For the European Communities, the decisive criterion for determining the "likeness" of products must be whether the basis for the regulatory distinction between products denies to imported products the treatment accorded to domestic products that are the subject of the relevant measure.

33. The European Communities contends that, because the Panel ignored the basis for the regulatory treatment set forth in the Decree, it compared the wrong products in its analysis of "likeness". The Decree prohibits *all carcinogenic asbestos fibres*, and it denies competitive opportunities to all such fibres equally. Thus, the prohibited carcinogenic asbestos fibres are not "like" the three substitute fibres because the application of the French regulatory distinction between them does not alter or affect the competitive opportunities of those substitute fibres. The European Communities concludes that, instead of comparing the products claimed by Canada to be "like" products (PVA, cellulose and glass fibres) with the category of products prohibited by the French Decree at issue (all carcinogenic asbestos fibres), the Panel erroneously compared the allegedly "like" products with an arbitrary third category of products, namely "fibres with certain industrial applications".<sup>23</sup>

34. The European Communities challenges the Panel's conclusion that, in view of the relationship between Articles III and XX(b) of the GATT 1994, it is not appropriate to take the "risk" criterion into account either when examining the properties, nature and quality of the product, or when examining other criteria of "likeness".<sup>24</sup> The Panel found that the health, safety or other concerns that lead regulators to apply different treatment to products may *only* be taken into account in the analysis under Article XX, *not* in the analysis under Article III:4 of the GATT 1994. The Panel's approach misconstrues the relationship between Articles III:4 and XX of the GATT 1994, requires the "likeness" of two products to be determined solely on the basis of commercial factors and, in the view of the European Communities, entails a serious curtailment of national regulatory autonomy. If non-commercial considerations may only be considered at the Article XX stage of the analysis, then the list of policy purposes for which regulators may distinguish between products is unduly limited to the

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<sup>23</sup>European Communities' other appellant's submission, para. 29.

<sup>24</sup>Panel Report, para. 8.132.

categories listed in Article XX. The application of a "risk" criterion in the analysis of "likeness" under Article III would not, as the Panel suggests, make the other criteria of "likeness" "totally redundant"<sup>25</sup>, since all relevant criteria, including the "risk" criterion, must be considered in the assessment of "likeness".

35. The European Communities contends that the Panel committed a number of errors in its application of the four criteria used to assess "likeness", and placed excessive importance on the criterion of end-use. The Panel failed to follow the approach used in previous case law, and ignored the fact that Article III:4 of the GATT 1994, unlike Article III:2 and its accompanying Interpretive Note, does not contain the phrase "directly competitive or substitutable" products. The Panel's analysis of "end-use" is inadequately reasoned, in particular since the Panel failed to identify the small number of identical or similar end-uses for chrysotile asbestos, PVA, cellulose and glass fibres and ignored that, overall, the end-uses for asbestos and its substitutes are very different. The European Communities adds that the Panel relied on its conclusions on end-use in its analysis of the properties, nature and quality of the products, as well as their tariff classification, and, in effect disregarded these other criteria.

2. Article XXIII:1(b) of the GATT 1994

36. The European Communities appeals the Panel's findings on Article XXIII:1(b) of the GATT 1994 in paragraphs 8.262, 8.264, 8.273 and 8.274 of the Panel Report, but not the Panel's conclusion that Canada did not establish nullification or impairment of a benefit within the meaning of Article XXIII:1(b). The Panel's reasoning is inconsistent with the proper interpretation of the GATT 1994, past practice, and relevant case law. Historically, the non-violation remedy was conceived as a legal instrument designed to prevent the circumvention of tariff concessions. Only three non-violation complaints have succeeded. All previous non-violation complaints have related to measures imposed for commercial purposes, and all such complaints would today most likely be resolved as violation complaints under the expanded WTO competence, reflected in the covered agreements. The European Communities urges the Appellate Body to accept that the concept of non-violation nullification and impairment is an exceptional one, as WTO Members have recognized, and should be applied with utmost circumspection.

37. The European Communities challenges, in particular, the Panel's conclusion that "Article XXIII:1(b) applies to a measure whether it is consistent with the GATT because the GATT does not apply to it or is justified by Article XX."<sup>26</sup> In so finding, the Panel wrongly implied that

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<sup>25</sup>Panel Report, para. 8.131.

<sup>26</sup>*Ibid.*, para. 8.264.

Article XXIII:1(b) of the GATT 1994 protects the expectation that, once a tariff concession has been made for a product, the regulatory framework applicable to that product will not be adapted in response to new scientific knowledge concerning health risks. In the view of the European Communities, the Panel's interpretation wrongly expanded the coverage of Article XXIII:1(b) in a manner that has grave systemic implications.

38. The European Communities urges the Appellate Body to reject, as a matter of legal principle, the possibility of finding nullification or impairment under Article XXIII:1(b) with respect to health and safety regulations, or with respect to measures that fall under any of the other grounds listed in Article XX, or under provisions such as Articles XIX and XXI of the GATT 1994. Article XXIII:1(b) cannot apply in cases involving health measures, since the legitimacy of an exporting Member's expectation that the health measure will not be taken cannot be assessed without examining the health measure itself and the balance of interests underlying that law. The participants in the Uruguay Round knew that the value of the concessions negotiated in that Round could be adversely affected by measures taken to protect, *inter alia*, human, animal or plant life or health, or a national security interest. Therefore, the European Communities concludes, if a Member takes a measure that is consistent with the GATT 1994, it does not disturb the balance of rights and obligations under the GATT 1994, and no redress is available under Article XXIII:1(b).

D. *Arguments of Canada – Appellee*

I. "Like Products" in Article III:4 of the GATT 1994

39. Canada requests the Appellate Body to dismiss the European Communities' appeal relating to Article III:4 of the GATT 1994. Canada is of the view that the Panel correctly separated the analysis of "likeness" from the issue of whether the competitive opportunities afforded to imports on the domestic market have been upset. In its appeal, the European Communities confounds these two distinct questions and attaches undue significance to the Panel's statement regarding the importance of "market access" under Article III:4 of the GATT 1994.

40. Canada considers that the Panel properly applied the criteria set out in the case law for determining whether products are "like". The European Communities appears to confuse the concept of "likeness" under Article III:4 of the GATT 1994 with "likeness" under Article III:2. "Likeness", however, under Article III:4 is different from, and broader than, "likeness" under the first sentence of Article III:2, and the Panel's approach properly reflects this distinction. In assessing the "likeness" of the fibres, the Panel recognized that the criteria of "properties" and "end-use" are interdependent, and analyzed them accordingly. Canada does not accept that the Panel created a hierarchy among the traditional "likeness" criteria, but, even so, this would not be an error of law, since "likeness" must be

approached on a case-by-case basis, and it is within a panel's discretion to establish a hierarchy among the criteria in any given case. Finally, Canada notes, the appeal of the European Communities focuses on the Panel's conclusion that chrysotile asbestos fibres are "like" PVA, cellulose and glass fibres, and the criticisms that the European Communities makes of this conclusion cannot be extended to the Panel's separate conclusion that chrysotile-cement products are "like" fibro-cement products.

41. Canada submits that the Panel correctly decided that the "dangerousness" of a product is not a factor to be considered in determining "likeness" and that to introduce a criterion of this nature into the analysis of "likeness" would nullify the effect of Article XX(b) of the GATT 1994. The object and purpose of Article III of the GATT 1994 is to provide equality of competitive conditions for imported and domestic products, and the four traditional criteria of "likeness" all relate to the state of *commercial* competition between such products. The "dangerousness" of products is unrelated to such commercial competition. Furthermore, to introduce such factors into the analysis of "likeness" under Article III:4 would lead to unpredictability as to the scope of that provision, and imply that determining the "likeness" of products requires complex scientific analysis for which panels have no special expertise. Canada adds that even if the "dangerousness" of a product were relevant to the determination of "likeness", it would not necessarily follow that chrysotile asbestos fibres are not "like" the substitute fibres. Since Article XX of the GATT 1994 was specially designed to balance the interest of promoting international trade with legitimate societal interests, it is a more appropriate framework than Article III for taking account of these types of considerations. Canada also stresses that, contrary to the argument of the European Communities, such an approach does not lead to a curtailment of national regulatory autonomy, because the list in Article XX covers a broad range of interests on the basis of which a Member may justify a measure.

42. Canada also submits that, in its appeal, the European Communities errs in asserting that the examination of "likeness" must be done on the basis of the regulatory distinction in question, and in claiming that the Panel should only have compared chrysotile asbestos fibres with carcinogenic fibres, rather than with other fibres that serve similar industrial uses. Such an approach is inconsistent with the proper interpretation of Article III:4. In seeking to focus the analysis on the reason for any given regulatory distinction, the European Communities would allow national regulatory authorities to predetermine the scope of Article III:4 through the distinctions they choose to make. Such an approach is also inconsistent with the object and purpose of Article III:4, which aims to discipline measures that have trade-restrictive effects, even when those measures are not aimed at restricting trade. Finally, in Canada's view, the Panel correctly compared chrysotile asbestos fibres with the fibres with which they compete in certain industrial applications, since such a comparison is consistent with the aim of providing equality of competitive conditions, and since the Decree itself makes no reference to carcinogenic fibres.

2. Article XXIII:1(b) of the GATT 1994

43. Canada requests the Appellate Body to reject the European Communities' appeal with respect to Article XXIII:1(b) of the GATT 1994. Canada suggests, first, that the Appellate Body should apply the principle of judicial economy and refrain from ruling on these grounds of appeal. Canada argues that a ruling by the Appellate Body in respect of Article XXIII:1(b) of the GATT 1994 would not further the objective of dispute settlement, as set forth in Article 3.7 of the DSU, namely to secure a positive solution to a dispute. There is no dispute concerning Article XXIII:1(b) because neither party has appealed the Panel's conclusions on this issue. Canada also refers to Article 3.2 of the DSU and cautions the Appellate Body against "making law" by clarifying provisions of the *WTO Agreement* outside the context of resolving a particular dispute.<sup>27</sup>

44. Should the Appellate Body address the interpretation of Article XXIII:1(b) of the GATT 1994, Canada invites it to affirm the Panel's reasoning, in particular the Panel's recognition that there may be particularly exceptional cases in which a measure justified under Article XX(b) would nonetheless nullify or impair benefits within the meaning of Article XXIII:1(b). Article XX(b) and XXIII:1(b) may be applied simultaneously, since Article 26.1 of the DSU does not require the withdrawal of a measure that nullifies or impairs benefits within the meaning of Article XXIII:1(b). As regards the concept of legitimate expectations, Canada rejects as artificial, and without any textual basis, the distinction that the European Communities seeks to draw between pure trade measures and measures linked to the protection of health.

E. *Arguments of the Third Participants*

1. Brazil

(a) *TBT Agreement*

45. Brazil believes that the Panel erred in its findings regarding the scope of the *TBT Agreement*. Brazil argues that the Panel erred in dividing the Decree into two separate parts in determining whether the *TBT Agreement* applies to the Decree. This division was arbitrary and inconsistent with the logic and objectives of the Decree, which deals with the same products in both the prohibition and the exception parts. Furthermore, Brazil is particularly concerned by the findings of the Panel in paragraphs 8.38, 8.39, 8.43, 8.49, 8.57, 8.60, 8.61 and 8.71 of the Panel Report, and by the serious systemic implications of the finding that a general prohibition does not constitute a technical regulation within the meaning of Annex 1.1 of the *TBT Agreement*. Contrary to the Panel's

interpretation, nothing in the *TBT Agreement* specifies that a product must be "identifiable", or that a measure must relate to one, or more than one product, in order to be a technical regulation. Such a narrow interpretation unduly excludes from the scope of the *TBT Agreement* a wide range of measures affecting products that could potentially represent barriers to trade. Brazil also contests the Panel's finding that a technical regulation must include specifications to be met in order for a product to be authorized for *marketing*. Brazil adds that, in its view, both France and the European Communities conceded, when they notified the Decree under the *TBT Agreement*, that the measure is a technical regulation.

2. United States

(a) *TBT Agreement*

46. The United States argues that the Panel erred in its interpretation of the phrase "technical regulation" in Annex 1 to the *TBT Agreement*, and, in consequence, improperly excluded from the scope of the *TBT Agreement* technical regulations that apply generally to products. Specifically, the United States contends that the Panel erred in finding that the phrase "product characteristics" in the definition of "technical regulation" refers to characteristics of "one or more given products", rather than characteristics of products generally.

47. Should the Appellate Body find that the *TBT Agreement* applies to the Decree and decide to complete the analysis of Canada's claims under that Agreement, the United States submits that the Appellate Body should find that the Decree is consistent with the *TBT Agreement*. Asbestos and asbestos-containing products, on the one hand, and substitute fibres and asbestos-free products, on the other, are not "like products" within the meaning of Article 2.1 of the *TBT Agreement* for the same reasons that they are not "like products" for the purposes of Article III:4 of the GATT 1994. The test to be applied under Article 2.2 of the *TBT Agreement* is very similar to the test to be applied under Article XX(b) and the introductory clause to Article XX. However, unlike Article XX of the GATT 1994, where the burden was on the European Communities to present a *prima facie* case that the Decree was justified, under Article 2.2 of the *TBT Agreement*, it is for Canada to make a *prima facie* case that the Decree creates an unnecessary barrier to trade, and it has not done so. The Decree is also consistent with Article 2.4 of the *TBT Agreement*, since the international standards identified by Canada are neither relevant to, nor an effective or appropriate means of achieving, France's public health objective. Lastly, the United States argues that the Decree is consistent with Article 2.8 of the *TBT Agreement*, since it would be inappropriate to express the technical regulation in any way other than as a prohibition on the use of asbestos.

<sup>27</sup> Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R, adopted 23 May 1997, DSR 1997:1, 323, at 340.

(b) "Like Products" in Article III:4 of the GATT 1994

48. The United States submits that the Panel erred in concluding that asbestos fibres and substitute fibres are "like products" under Article III:4 of the GATT 1994. The Panel erred in law in concluding that, in examining the properties, nature and quality of asbestos, it could not take into account the fact that asbestos differs from other fibres because it splits longitudinally into narrow, or thin, fibres, and has a high potential to release particles that possess certain characteristics, and in concluding that, in examining consumer tastes and habits, it could not take account of the proven carcinogenic nature of asbestos. In so proceeding, the Panel ignored the single most important distinguishing feature between asbestos and its substitutes. The Panel also wrongly inflated the significance of another factor – the end uses of products concerned. In the view of the United States, the application of a proper "like product" analysis should lead the Appellate Body to find that asbestos is not "like" its substitute fibres, and that asbestos-containing products are not "like" asbestos-free products and, therefore, conclude that the Decree does not violate Article III:4 of the GATT 1994.

(c) Article XX(b) of the GATT 1994 and Article 11 of the DSU

49. Should the Appellate Body resort to Article XX(b) of the GATT 1994, the United States urges the Appellate Body to find that the Decree is permissible under Article XX(b). Canada's appeal on this issue is based on criticism of the Panel's findings with respect to the scientific information before it, and that Canada erroneously asserts that Article 11 of the DSU requires the Panel to decide which scientific view is the correct one. However, the role of a panel, under Article 11 of the DSU, is to make an objective assessment of the facts before it, and to evaluate whether there is a rational or objective relationship between the measure at issue and the scientific basis asserted for the measure. The United States argues that the Panel acted consistently with this mandate in finding that the Decree is necessary to protect human health, and the Appellate Body should not disturb this finding.

### III. Preliminary Procedural Matter

50. On 27 October 2000, we wrote to the parties and the third parties indicating that we were mindful that, in the proceedings before the Panel in this case, the Panel received five written submissions from non-governmental organizations, two of which the Panel decided to take into account.<sup>28</sup> In our letter, we recognized the possibility that we might receive submissions in this appeal from persons other than the parties and the third parties to this dispute, and stated that we were of the view that the fair and orderly conduct of this appeal could be facilitated by the adoption of appropriate procedures, for the purposes of this appeal only, pursuant to Rule 16(1) of the

*Working Procedures*, to deal with any possible submissions received from such persons. To this end, we invited the parties and the third parties in this appeal to submit their comments on a number of questions. These related to: whether we should adopt a "request for leave" procedure; what procedures would be needed to ensure that the parties and third parties would have a full and adequate opportunity to respond to submissions that might be received; and whether we should take any other points into consideration if we decided to adopt a "request for leave" procedure. On 3 November 2000, all of the parties and third parties responded in writing to our letter of 27 October. Canada, the European Communities and Brazil considered that issues pertaining to any such procedure should be dealt with by the WTO Members themselves. The United States welcomed adoption of a request for leave procedure, and Zimbabwe indicated that it had no specific reasons to oppose adoption of a request for leave procedure. Without prejudice to their positions, Canada, the European Communities and the United States each made a number of suggestions regarding any such procedure that might be adopted.

51. On 7 November 2000, and after consultations among all seven Members of the Appellate Body, we adopted, pursuant to Rule 16(1) of the *Working Procedures*, an additional procedure, for the purposes of this appeal only, to deal with written submissions received from persons other than the parties and third parties to this dispute (the "Additional Procedure"). The Additional Procedure was communicated to the parties and third parties in this appeal on 7 November 2000. On 8 November 2000, the Chairman of the Appellate Body informed the Chairman of the Dispute Settlement Body, in writing, of the Additional Procedure adopted, and this letter was circulated, for information, as a dispute settlement document to the Members of the WTO.<sup>29</sup> In that communication, the Chairman of the Appellate Body stated that:

... This additional procedure has been adopted by the Division hearing this appeal for the purposes of this appeal only pursuant to Rule 16(1) of the *Working Procedures for Appellate Review*, and is *not* a new working procedure drawn up by the Appellate Body pursuant to paragraph 9 of Article 17 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes*. (original emphasis)

The Additional Procedure was posted on the WTO website on 8 November 2000.

52. The Additional Procedure provided:

<sup>28</sup>Panel Report, paras. 6.1-6.4 and 8.12-8.14.

<sup>29</sup>WT/DS135/9, 8 November 2000.

1. In the interests of fairness and orderly procedure in the conduct of this appeal, the Division hearing this appeal has decided to adopt, pursuant to Rule 16(1) of the *Working Procedures for Appellate Review*, and after consultations with the parties and third parties to this dispute, the following additional procedure for purposes of this appeal only.
2. Any person, whether natural or legal, other than a party or a third party to this dispute, wishing to file a written brief with the Appellate Body, must apply for leave to file such a brief from the Appellate Body *by noon on Thursday, 16 November 2000*.
3. An application for leave to file such a written brief shall:
  - (a) be made in writing, be dated and signed by the applicant, and include the address and other contact details of the applicant;
  - (b) be in no case longer than three typed pages;
  - (c) contain a description of the applicant, including a statement of the membership and legal status of the applicant, the general objectives pursued by the applicant, the nature of the activities of the applicant, and the sources of financing of the applicant;
  - (d) specify the nature of the interest the applicant has in this appeal;
  - (e) identify the specific issues of law covered in the Panel Report and legal interpretations developed by the Panel that are the subject of this appeal, as set forth in the Notice of Appeal (WT/DS135/8) dated 23 October 2000, which the applicant intends to address in its written brief;
  - (f) state why it would be desirable, in the interests of achieving a satisfactory settlement of the matter at issue, in accordance with the rights and obligations of WTO Members under the DSU and the other covered agreements, for the Appellate Body to grant the applicant leave to file a written brief in this appeal; and indicate, in particular, in what way the applicant will make a contribution to the resolution of this dispute that is not likely to be repetitive of what has been already submitted by a party or third party to this dispute; and
  - (g) contain a statement disclosing whether the applicant has any relationship, direct or indirect, with any party or any third party to this dispute, as well as whether it has, or will, receive any assistance, financial or otherwise, from a party or a third party to this dispute in the preparation of its application for leave or its written brief.

4. The Appellate Body will review and consider each application for leave to file a written brief and will, without delay, render a decision whether to grant or deny such leave.
  5. The grant of leave to file a brief by the Appellate Body does not imply that the Appellate Body will address, in its Report, the legal arguments made in such a brief.
  6. Any person, other than a party or a third party to this dispute, granted leave to file a written brief with the Appellate Body, must file its brief with the Appellate Body Secretariat *by noon on Monday, 27 November 2000*.
  7. A written brief filed with the Appellate Body by an applicant granted leave to file such a brief shall:
    - (a) be dated and signed by the person filing the brief;
    - (b) be concise and in no case longer than 20 typed pages, including any appendices; and
    - (c) set out a precise statement, strictly limited to legal arguments, supporting the applicant's legal position on the issues of law or legal interpretations in the Panel Report with respect to which the applicant has been granted leave to file a written brief.
  8. An applicant granted leave shall, in addition to filing its written brief with the Appellate Body Secretariat, also serve a copy of its brief on all the parties and third parties to the dispute *by noon on Monday, 27 November 2000*.
  9. The parties and the third parties to this dispute will be given a full and adequate opportunity by the Appellate Body to comment on and respond to any written brief filed with the Appellate Body by an applicant granted leave under this procedure. (original emphasis)
53. The Appellate Body received 13 written submissions from non-governmental organizations relating to this appeal that were not submitted in accordance with the Additional Procedure.<sup>30</sup> Several of these were received while we were considering the possible adoption of an additional procedure. After the adoption of the Additional Procedure, each of these 13 submissions was returned to its sender, along with a letter informing the sender of the procedure adopted by the Division hearing this
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- <sup>30</sup>Such submissions were received from: Asbestos Information Association (United States); HVL Asbestos (Swaziland) Limited (Bulembu Mine); South African Asbestos Producers Advisory Committee (South Africa); J & S Bridle Associates (United Kingdom); Associação das Indústrias de Produtos de Amianto Crisólito (Portugal); Asbestos Cement Industries Limited (Sri Lanka); The Federation of Thai Industries, Roofing and Accessories Club (Thailand); Korea Asbestos Association (Korea); Senac (Senegal); Syndicat des Métallos (Canada); Duralita de Centroamerica, S.A. de C.V. (El Salvador); Asociación Colombiana de Fibras (Colombia); and Japan Asbestos Association (Japan).

appeal and a copy of the Additional Procedure. Only one of these associations, the Korea Asbestos Association, subsequently submitted a request for leave in accordance with the Additional Procedure.

54. By letter dated 15 November 2000, Canada and the European Communities jointly requested that they be provided with copies of all applications filed pursuant to the Additional Procedure, and of the decision taken by the Appellate Body in respect of each such application. All such documents were subsequently provided to the parties and third parties in this dispute.

55. Pursuant to the Additional Procedure, the Appellate Body received 17 applications requesting leave to file a written brief in this appeal. Six of these 17 applications were received after the deadline specified in paragraph 2 of the Additional Procedure and, for this reason, leave to file a written brief was denied to these six applicants.<sup>31</sup> Each such applicant was sent a copy of our decision denying its application for leave because the application was not filed in a timely manner.

56. The Appellate Body received 11 applications for leave to file a written brief in this appeal within the time limits specified in paragraph 2 of the Additional Procedure.<sup>32</sup> We carefully reviewed and considered each of these applications in accordance with the Additional Procedure and, in each case, decided to deny leave to file a written brief. Each applicant was sent a copy of our decision denying its application for leave for failure to comply sufficiently with all the requirements set forth in paragraph 3 of the Additional Procedure.

57. We received a written brief from the Foundation for International Environmental Law and Development, on its behalf and on behalf of Ban Asbestos (International and Virtual) Network, Greenpeace International, International Ban Asbestos Secretariat, and World Wide Fund for Nature, International, dated 6 February 2001. As we had already denied, in accordance with the Additional

<sup>31</sup>Applications from the following persons were received by the Division after the deadline specified in the Additional Procedure for receipt of such applications: Association of Personal Injury Lawyers (United Kingdom); All India A.C. Pressure Pipe Manufacturer's Association (India); International Confederation of Free Trade Unions/European Trade Union Confederation (Belgium); Maharashtra Asbestos Cement Pipe Manufacturers' Association (India); Roofit Industries Ltd. (India); and Society for Occupational and Environmental Health (United States).

<sup>32</sup>Applications from the following persons were received by the Division within the deadline specified in the Additional Procedure for receipt of such applications: Professor Robert Lloyd Howse (United States); Occupational & Environmental Diseases Association (United Kingdom); American Public Health Association (United States); Centro de Estudios Comunitarios de la Universidad Nacional de Rosario (Argentina); Only Nature Endures (India); Korea Asbestos Association (Korea); International Council on Metals and the Environment and American Chemistry Council (United States); European Chemical Industry Council (Belgium); Australian Centre for Environmental Law at the Australian National University (Australia); Associate Professor Jan McDonald and Mr. Don Anton (Australia); and a joint application from Foundation for Environmental Law and Development (United Kingdom), Center for International Environmental Law (Switzerland), International Ban Asbestos Secretariat (United Kingdom), Ban Asbestos International and Virtual Network (France), Greenpeace International (The Netherlands), World Wide Fund for Nature, International (Switzerland), and Lutheran World Federation (Switzerland).

Procedure, an application from these organizations for leave to file a written brief in this appeal<sup>33</sup>, we did not accept this brief.

#### IV. Issues Raised in this Appeal

58. This appeal raises the following issues:

- (a) whether the Panel erred in its interpretation of the term "technical regulation" in Annex 1.1 of the *TBT Agreement* in finding, in paragraph 8.72(a) of the Panel Report, that "the part of the Decree relating to the ban on imports of asbestos and asbestos-containing products" does not constitute a "technical regulation";
- (b) whether the Panel erred in its interpretation and application of the term "like products" in Article III:4 of the GATT 1994 in finding, in paragraph 8.144 of the Panel Report, that chrysotile asbestos fibres are "like" PVA, cellulose and glass fibres, and in finding, in paragraph 8.150 of the Panel Report, that cement-based products containing chrysotile asbestos fibres are "like" cement-based products containing polyvinyl alcohol, cellulose and glass fibres;
- (c) whether the Panel erred in finding that the measure at issue is "necessary to protect human ... life or health" under Article XX(b) of the GATT 1994, and whether, in carrying out its examination under Article XX(b) of the GATT 1994, the Panel failed to make an objective assessment of the matter under Article 11 of the DSU; and
- (d) whether the Panel erred in its interpretation of Article XXIII:1(b) of the GATT 1994 in finding that that provision applies to a measure which falls within the scope of application of other provisions of the GATT 1994, and in finding that Article XXIII:1(b) applies to measures which pursue health objectives.

#### V. TBT Agreement

59. Before the Panel, Canada claimed that the measure at issue is inconsistent with Articles 2.1, 2.2, 2.4 and 2.8 of the *TBT Agreement*. Each of these provisions applies solely to "technical regulations". Thus, a threshold issue in the examination of Canada's claims under the *TBT Agreement* is whether the measure at issue is a "technical regulation".

<sup>33</sup>These organizations, together with the Center for International Environmental Law and the Lutheran World Federation, filed a joint application for leave to file a written brief. We decided to deny leave to these applicants to file a written brief. See *supra*, para. 56 and footnote 32.

60. In addressing this threshold issue, the Panel examined the nature and structure of the measure to assess how the *TBT Agreement* might apply to it. For this examination, the Panel decided that it would be appropriate to examine the measure in two stages. First, the Panel examined "the part of the Decree prohibiting the marketing of asbestos and asbestos-containing products"; next, the Panel analyzed the "exceptions" in the Decree.<sup>34</sup> The Panel concluded that the part of the Decree containing the prohibitions is *not* a "technical regulation", and that, therefore, the *TBT Agreement* does not apply to this part of the Decree.<sup>35</sup> However, the Panel also concluded that the part of the Decree containing the exceptions does constitute a "technical regulation", and that, therefore, the *TBT Agreement* applies to that part of the Decree. On this basis, the Panel decided not to examine Canada's claims under the *TBT Agreement* because, it said, those claims relate solely to the part of the Decree containing the prohibitions, which, in the Panel's view, does not constitute a "technical regulation", and, therefore, the *TBT Agreement* does not apply.<sup>36</sup>

61. In concluding that the part of the Decree containing the prohibitions is not a "technical regulation", the Panel found that:

a measure constitutes a "technical regulation" if:

- (a) the measure affects one or more given products;
- (b) the measure specifies the technical characteristics of the product(s) which allow them to be marketed in the Member that took the measure;
- (c) compliance is mandatory.<sup>37</sup>

62. Canada appeals the Panel's finding that the *TBT Agreement* does not apply to the part of the Decree relating to the prohibitions on imports of asbestos and asbestos-containing products. According to Canada, the Panel erred in considering the part of the Decree relating to those prohibitions *separately* from the part of the Decree relating to the exceptions to those prohibitions, and, therefore, the Panel should have examined the Decree as a *single*, unified measure. Furthermore, Canada argues that the Panel erred in its interpretation of a "technical regulation", as defined in Annex I.1 to the *TBT Agreement*, because, in Canada's view, a general prohibition can be a "technical regulation".

<sup>34</sup>Panel Report, heading (a) on p. 404 and heading (b) on p. 411.

<sup>35</sup>*Ibid.*, para. 8.72(a).

<sup>36</sup>*Ibid.*, para. 8.72.

<sup>37</sup>*Ibid.*, para. 8.57.

63. We start with the measure at issue. It is clear from Canada's request for the establishment of a panel that Canada's complaint concerns Decree 96-1133 as a whole.<sup>38</sup> The Decree, in essence, consists of prohibitions on asbestos fibres and on products containing asbestos fibres (Article 1), coupled with limited and temporary exceptions from the prohibitions for certain "existing materials, products or devices containing chrysotile fibre" (Article 2). The remaining operative provisions of the Decree contain additional rules governing the grant of an exception (Articles 3 and 4) and the imposition of penalties for violation of the prohibitions in Article 1 (Article 5). Furthermore, certain used "vehicles" and "agricultural and forestry machinery" are entirely excluded, until 31 December 2001, from certain aspects of the prohibitions in Article 1, namely, from the prohibitions on "possession for sale, offering for sale and transfer under any title" (Article 7).<sup>39</sup>

64. In our view, the proper legal character of the measure at issue cannot be determined unless the measure is examined as a whole. Article 1 of the Decree contains broad, general prohibitions on asbestos and products containing asbestos. However, the scope and generality of those prohibitions can only be understood in light of the exceptions to it which, albeit for a limited period, *permit*, *inter alia*, the use of certain products containing asbestos and, principally, products containing chrysotile asbestos fibres. The measure is, therefore, *not* a *total* prohibition on asbestos fibres, because it also includes provisions that *permit*, for a limited duration, the use of asbestos in certain situations. Thus, to characterize the measure simply as a general prohibition, and to examine it as such, overlooks the complexities of the measure, which include both prohibitive and permissive elements. In addition, we observe that the exceptions in the measure would have no autonomous legal significance in the absence of the prohibitions. We, therefore, conclude that the measure at issue is to be examined as an integrated whole, taking into account, as appropriate, the prohibitive and the permissive elements that are part of it.

65. Accordingly, we reverse the Panel's two-stage interpretive approach of examining, first, the application of the *TBT Agreement* to the prohibitions contained in the measure and, second and separately, its application to the exceptions contained in the measure.

<sup>38</sup>WT/DS135/3. In its request for the establishment of a panel, Canada stated:

... the Government of Canada requested consultations with the European Communities concerning certain measures taken by France prohibiting asbestos and products containing asbestos, and concerning the general asbestos regulations in force in France. *These measures and regulations include*, but are not limited to, *Decree No. 96-1133 ...* (emphasis added)

Canada requested that the Panel "find that *Decree No. 96-1133*" is inconsistent with the European Communities' WTO obligations. (emphasis added) See, further, Canada's request for consultations, WT/DS135/1, G/SPS/GEN/72, G/TBT/D/15, which also identifies the measure at issue as Decree No. 96-1133.

<sup>39</sup>The full text of the Decree is reproduced in Annex I in the Addendum to the Panel Report. Articles 1 and 2 of the Decree are reproduced in paragraph 2 of this Report.

66. We turn now to the term "technical regulation" and to the considerations that must go into interpreting the term. Article 1.2 of the *TBT Agreement* provides that, for the purposes of this Agreement, the meanings given in Annex 1 apply. Annex 1.1 of the *TBT Agreement* defines a "technical regulation" as a:

Document which lays down *product characteristics* or their related processes and production methods, including the *applicable administrative provisions*, with which *compliance is mandatory*. It may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method. (emphasis added)

67. The heart of the definition of a "technical regulation" is that a "document" must "lay down" – that is, set forth, stipulate or provide – "product characteristics". The word "characteristic" has a number of synonyms that are helpful in understanding the ordinary meaning of that word, in this context. Thus, the "characteristics" of a product include, in our view, any objectively definable "features", "qualities", "attributes", or other "distinguishing mark" of a product. Such "characteristics" might relate, *inter alia*, to a product's composition, size, shape, colour, texture, hardness, tensile strength, flammability, conductivity, density, or viscosity. In the definition of a "technical regulation" in Annex 1.1, the *TBT Agreement* itself gives certain examples of "product characteristics" – "terminology, symbols, packaging, marking or labelling requirements". These examples indicate that "product characteristics" include, not only features and qualities intrinsic to the product itself, but also related "characteristics", such as the means of identification, the presentation and the appearance of a product. In addition, according to the definition in Annex 1.1 of the *TBT Agreement*, a "technical regulation" may set forth the "applicable administrative provisions" for products which have certain "characteristics". Further, we note that the definition of a "technical regulation" provides that such a regulation "may also include or deal *exclusively* with terminology, symbols, packaging, marking or labelling requirements". (emphasis added) The use here of the word "exclusively" and the disjunctive word "or" indicates that a "technical regulation" may be confined to laying down only one or a few "product characteristics".

68. The definition of a "technical regulation" in Annex 1.1 of the *TBT Agreement* also states that "compliance" with the "product characteristics" laid down in the "document" must be "mandatory". A "technical regulation" must, in other words, regulate the "characteristics" of products in a binding or compulsory fashion. It follows that, with respect to products, a "technical regulation" has the effect of *prescribing* or *imposing* one or more "characteristics" – "features", "qualities", "attributes", or other "distinguishing mark".

69. "Product characteristics" may, in our view, be prescribed or imposed with respect to products in either a positive or a negative form. That is, the document may provide, positively, that products *must possess* certain "characteristics", or the document may require, negatively, that products *must not possess* certain "characteristics". In both cases, the legal result is the same: the document "lays down" certain binding "characteristics" for products, in one case affirmatively, and in the other by negative implication.

70. A "technical regulation" must, of course, be applicable to an *identifiable* product, or group of products. Otherwise, enforcement of the regulation will, in practical terms, be impossible. This consideration also underlies the formal obligation, in Article 2.9.2 of the *TBT Agreement*, for Members to notify other Members, through the WTO Secretariat, "of the *products to be covered*" by a proposed "technical regulation". (emphasis added) Clearly, compliance with this obligation requires identification of the product coverage of a technical regulation. However, in contrast to what the Panel suggested, this does not mean that a "technical regulation" must apply to "*given*" products which are actually *named, identified* or *specified* in the regulation.<sup>40</sup> (emphasis added) Although the *TBT Agreement* clearly applies to "products" generally, nothing in the text of that Agreement suggests that those products need be named or otherwise *expressly* identified in a "technical regulation". Moreover, there may be perfectly sound administrative reasons for formulating a "technical regulation" in a way that does *not* expressly identify products by name, but simply makes them identifiable – for instance, through the "characteristic" that is the subject of regulation.

71. With these considerations in mind, we examine whether the measure at issue is a "technical regulation". Decree 96-1133 aims primarily at the regulation of a named product, asbestos. The first and second paragraphs of Article 1 of the Decree impose a prohibition on asbestos *fibres*, as such. This prohibition on these *fibres* does not, *in itself*, prescribe or impose any "characteristics" on asbestos fibres, but simply bans them in their natural state. Accordingly, if this measure consisted *only* of a prohibition on asbestos *fibres*, it might not constitute a "technical regulation".

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<sup>40</sup>Panel Report, para. 8.57. We note that the Panel stated that a "technical regulation" must apply to "*identifiable*" products (Panel Report, para. 8.38; emphasis added). However, the Panel went on to state that a "technical regulation" must apply to "*given*" products (Panel Report, para. 8.57; emphasis added). The Panel also noted that the measure does not "identify *by name* nor even by function or category" the products covered by the measure (Panel Report, para. 8.40; emphasis added). Thus, in parts of the Panel Report, the Panel appears to require that a "technical regulation" apply to *given* products rather than *identifiable* products.

72. There is, however, more to the measure than this prohibition on asbestos fibres. It is not contested that asbestos fibres have no known use in their raw mineral form.<sup>41</sup> Thus, the regulation of asbestos can *only* be achieved through the regulation of *products that contain asbestos fibres*. This, too, is addressed by the Decree before us. An integral and essential aspect of the measure is the regulation of "*products containing asbestos fibres*", which are also prohibited by Article 1, paragraphs I and II of the Decree. It is important to note here that, although formulated *negatively* – products containing asbestos are prohibited – the measure, in this respect, effectively prescribes or imposes certain objective features, qualities or "characteristics" on *all* products. That is, in effect, the measure provides that *all* products must *not* contain asbestos fibres. Although this prohibition against products containing asbestos applies to a large number of products, and although it is, indeed, true that the products to which this prohibition applies cannot be determined from the terms of the measure itself, it seems to us that the products covered by the measure are *identifiable*: all products must be asbestos free; any products containing asbestos are prohibited. We also observe that compliance with the prohibition against products containing asbestos is mandatory and is, indeed, enforceable through criminal sanctions.<sup>42</sup>

73. Articles 2, 3 and 4 of the Decree also contain certain exceptions to the prohibitions found in Article 1 of the Decree. As we have already noted, these exceptions would have no meaning in the absence of the rest of the measure because they define the scope of the prohibitions in the measure. The nature of these exceptions is to *permit* the use of certain products containing chrysotile asbestos fibres, subject to compliance with strict administrative requirements. The scope of the exceptions is determined by an "exhaustive list" of products that are permitted to contain chrysotile asbestos fibres, which is promulgated and reviewed annually by a government Minister.<sup>43</sup> The inclusion of a product in the list of exceptions depends on the absence of an acceptable alternative fibre for incorporation into a particular product, and the demonstrable provision of "all technical guarantees of safety".<sup>44</sup> Any person seeking to avail himself of these limited exceptions must provide a detailed justification to the authorities, complete with necessary supporting documentation concerning "the state of

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<sup>41</sup>Canada asserted that "chrysotile fibre has no use in its raw form; it serves as an input in the production of chrysotile materials" (Panel Report, paras. 3.418 and 3.439). This assertion is not contested by the European Communities.

<sup>42</sup>Article 5 of the Decree characterizes a contravention of any aspect of Articles 1.1 or 1.11 as a "5<sup>th</sup> class offence".

<sup>43</sup>Article 2.II of the Decree.

<sup>44</sup>Article 2.I of the Decree.

scientific and technological progress".<sup>45</sup> Compliance with these administrative requirements is mandatory.<sup>46</sup>

74. Like the Panel, we consider that, through these exceptions, the measure sets out the "applicable administrative provisions, with which compliance is mandatory" for products with certain objective "characteristics".<sup>47</sup> The exceptions apply to a narrowly defined group of products with particular "characteristics". Although these products are not named, the measure provides criteria which permit their identification, both by reference to the qualities the excepted products must possess and by reference to the list promulgated by the Minister.

75. Viewing the measure as an integrated whole, we see that it lays down "characteristics" for all products that might contain asbestos, and we see also that it lays down the "applicable administrative provisions" for certain products containing chrysotile asbestos fibres which are excluded from the prohibitions in the measure. Accordingly, we find that the measure is a "document" which "lays down product characteristics ... including the applicable administrative provisions, with which compliance is mandatory." For these reasons, we conclude that the measure constitutes a "technical regulation" under the *TBT Agreement*.

76. We, therefore, reverse the Panel's finding, in paragraph 8.72(a) of the Panel Report, that the *TBT Agreement* "does not apply to the part of the Decree relating to the ban on imports of asbestos and asbestos-containing products because that part does not constitute a 'technical regulation' within the meaning of Annex 1.1 to the TBT Agreement."

77. We note, however – and we emphasize – that this does not mean that *all* internal measures covered by Article III:4 of the GATT 1994 "affecting" the "sale, offering for sale, purchase, transportation, distribution or use" of a product are, necessarily, "technical regulations" under the *TBT Agreement*. Rather, we rule only that this particular measure, the Decree at stake, falls within the definition of a "technical regulation" given in Annex 1.1 of that Agreement.

78. As we have reached a different conclusion from the Panel's regarding the applicability of the *TBT Agreement* to the measure, we now consider whether it is appropriate for us to rule on the claims made by Canada relating to the *TBT Agreement*. In previous appeals, we have, on occasion, completed the legal analysis with a view to facilitating the prompt settlement of the dispute, pursuant

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<sup>45</sup>Article 3.I of the Decree.

<sup>46</sup>Article 3.II of the Decree limits the benefit of the exception to activities that have been the subject of the necessary formalities.

<sup>47</sup>Panel Report, para. 8.69.

to Article 3.3 of the DSU.<sup>48</sup> However, we have insisted that we can do so only if the factual findings of the panel and the undisputed facts in the panel record provide us with a sufficient basis for our own analysis. If that has not been the case, we have not completed the analysis.<sup>49</sup>

79. The need for sufficient facts is not the only limit on our ability to complete the legal analysis in any given case. In *Canada – Periodicals*, we reversed the panel's conclusion that the measure at issue was inconsistent with Article III:2, first sentence, of the GATT 1994, and we then proceeded to examine the United States' claims under Article III:2, second sentence, which the panel had not examined at all. However, in embarking there on an analysis of a provision that the panel had not considered, we emphasized that "the first and second sentences of Article III:2 are *closely related*" and that those two sentences are "part of a *logical continuum*."<sup>50</sup> (emphasis added)

80. In this appeal, Canada's outstanding claims were made under Articles 2.1, 2.2, 2.4 and 2.8 of the *TBT Agreement*. We observe that, although the *TBT Agreement* is intended to "further the objectives of GATT 1994", it does so through a specialized legal regime that applies solely to a limited class of measures. For these measures, the *TBT Agreement* imposes obligations on Members

<sup>48</sup>See, for instance, Appellate Body Report, *United States – Gasoline*, *supra*, footnote 15, at 18 ff; Appellate Body Report, *Canada – Certain Measures Concerning Periodicals* ("Canada – Periodicals"), WT/DS31/AB/R, adopted 30 July 1997, DSR 1997:1, 449, at 469 ff; Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)* ("European Communities – Hormones"), WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, paras. 222 ff; Appellate Body Report, *European Communities – Measures Affecting the Importation of Certain Poultry Products*, WT/DS69/AB/R, adopted 23 July 1998, paras. 156 ff; Appellate Body Report, *Australia – Measures Affecting Importation of Salmon* ("Australia – Salmon"), WT/DS18/AB/R, adopted 6 November 1998, paras. 117 ff, 193 ff and 227 ff; Appellate Body Report, *United States – Shrimp*, *supra*, footnote 14, paras. 123 ff; Appellate Body Report, *Japan – Measures Affecting Agricultural Products*, WT/DS76/AB/R, adopted 19 March 1999, paras. 112 ff; Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/AB/R, adopted 20 March 2000, paras. 133 ff; Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft, Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/AB/RW, adopted 4 August 2000, paras. 43 ff; and Appellate Body Report, *United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities* ("United States – Wheat Gluten"), WT/DS166/AB/R, adopted 19 January 2001, paras. 80 ff and 127 ff.

In addition, after modifying the panel's reasoning, we have, on occasion, applied our interpretation of the legal provisions at issue to the facts of the case (see, for instance, Appellate Body Report, *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS56/AB/R, adopted 22 April 1998, paras. 48 ff; Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/R, WT/DS113/AB/R, adopted 27 October 1999, paras. 138 ff; Appellate Body Report, *Argentina – Safeguard Measures on Imports of Footwear*, WT/DS121/AB/R, adopted 12 January 2000, paras. 109 ff).

<sup>49</sup>See Appellate Body Report, *Australia – Salmon*, *supra*, footnote 48, paras. 209 ff, 241 ff and 255; Appellate Body Report, *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, WT/DS98/AB/R, adopted 12 January 2000, paras. 91 ff and 102 ff; Appellate Body Report, *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/AB/R, WT/DS142/AB/R, adopted 19 June 2000, paras. 133 ff and 144 ff; Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef* ("Korea – Beef"), WT/DS161/AB/R, WT/DS169/AB/R, adopted 10 January 2001, paras. 128 ff.

<sup>50</sup>*Supra*, footnote 48, at 469.

that seem to be *different* from, and *additional* to, the obligations imposed on Members under the GATT 1994.

81. As the Panel decided not to examine Canada's four claims under the *TBT Agreement*, it made no findings, at all, regarding any of these claims. Moreover, the meaning of the different obligations in the *TBT Agreement* has not previously been the subject of any interpretation or application by either panels or the Appellate Body. Similarly, the provisions of the Tokyo Round *Agreement on Technical Barriers to Trade*, which preceded the *TBT Agreement* and which contained obligations similar to those in the *TBT Agreement*, were also never the subject of even a single ruling by a panel.

82. In light of their novel character, we consider that Canada's claims under the *TBT Agreement* have not been explored before us in depth. As the Panel did not address these claims, there are no "issues of law" or "legal interpretations" regarding them to be analyzed by the parties, and reviewed by us under Article 17.6 of the DSU. We also observe that the sufficiency of the facts on the record depends on the reach of the provisions of the *TBT Agreement* claimed to apply – a reach that has yet to be determined.

83. With this particular collection of circumstances in mind, we consider that we do not have an adequate basis properly to examine Canada's claims under Articles 2.1, 2.2, 2.4 and 2.8 of the *TBT Agreement* and, accordingly, we refrain from so doing.

## VI. "Like Products" in Article III:4 of the GATT 1994

### A. Background

84. In addressing Canada's claims under Article III:4 of the GATT 1994, the Panel examined whether two different sets of products are "like".<sup>51</sup> First, the Panel examined whether *chrysotile asbestos fibres* are "like" certain other fibres, namely *polyvinyl alcohol fibres ("PVA")*, *cellulose and glass fibres* (PVA, cellulose and glass fibres are all collectively referred to, in the remainder of this Report, as "PCG fibres"). The Panel concluded that chrysotile asbestos and PCG fibres are all "like products" under Article III:4.<sup>52</sup> The Panel next examined whether *cement-based products containing chrysotile asbestos fibres* are "like" *cement-based products containing one of the PCG fibres*. The Panel also concluded that all these cement-based products are "like".<sup>53</sup>

<sup>51</sup>The Panel's approach is set forth in para. 8.111 of the Panel Report.

<sup>52</sup>Panel Report, para. 8.144.

<sup>53</sup>*Ibid.*, para. 8.150.



*Agreement on Safeguards* and other covered agreements. In some cases, such as in Article 2.6 of the *Anti-Dumping Agreement*, the term is given a specific meaning to be used "[t]hroughout [the] Agreement", while in others, it is not. In each of the provisions where the term "like products" is used, the term must be interpreted in light of the context, and of the object and purpose, of the provision at issue, and of the object and purpose of the covered agreement in which the provision appears. Accordingly, and as we observed in an earlier case concerning Article III:2 of the GATT 1994:

... there can be *no one precise and absolute definition of what is "like"*. The concept of "likeness" is a relative one that evokes the image of an accord. The accord of "likeness" stretches and squeezes in different places as different provisions of the *WTO Agreement* are applied. *The width of the accord in any one of those places must be determined by the particular provision in which the term "like" is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply.* ...<sup>60</sup> (emphasis added)

89. It follows that, while the meaning attributed to the term "like products" in other provisions of the GATT 1994, or in other covered agreements, may be relevant context in interpreting Article III:4 of the GATT 1994, the interpretation of "like products" in Article III:4 need not be identical, in all respects, to those other meanings.

90. Bearing these considerations in mind, we turn now to the ordinary meaning of the word "like" in the term "like products" in Article III:4. According to one dictionary, "like" means:

Having the same characteristics or qualities as some other ... thing; of approximately identical shape, size, etc., with something else; similar.<sup>61</sup>

91. This meaning suggests that "like" products are products that share a number of identical or similar characteristics or qualities. The reference to "similar" as a synonym of "like" also echoes the language of the French version of Article III:4, "*produits similaires*", and the Spanish version, "*productos similares*", which, together with the English version, are equally authentic.<sup>62</sup>

<sup>60</sup> Appellate Body Report, *Japan – Alcoholic Beverages*, *supra*, footnote 58, at 114. We also cautioned against the automatic transposition of the interpretation of "likeness" under the first sentence of Article III:2 to other provisions where the phrase "like products" is used (p. 113).

<sup>61</sup> *The New Shorter Oxford English Dictionary*, Lesley Brown (ed.) (Clarendon Press, 1993), Vol. I, p. 1588.

<sup>62</sup> *WTO Agreement*, final, authenticating clause. See, also, Article 33(1) of the *Vienna Convention of the Law of the Treaties*, done at Vienna, 23 May 1969, 1155 U.N.T.S. 331; 8 International Legal Materials 679.

92. However, as we have previously observed, "dictionary meanings leave many interpretive questions open."<sup>63</sup> In particular, this definition does not resolve three issues of interpretation. First, this dictionary definition of "like" does not indicate *which characteristics or qualities are important* in assessing the "likeness" of products under Article III:4. For instance, most products will have many qualities and characteristics, ranging from physical properties such as composition, size, shape, texture, and possibly taste and smell, to the end-uses and applications of the product. Second, this dictionary definition provides no guidance in determining the *degree or extent to which products must share qualities or characteristics* in order to be "like products" under Article III:4. Products may share only very few characteristics or qualities, or they may share many. Thus, in the abstract, the term "like" can encompass a spectrum of differing degrees of "likeness" or "similarity". Third, this dictionary definition of "like" does not indicate *from whose perspective* "likeness" should be judged. For instance, ultimate consumers may have a view about the "likeness" of two products that is very different from that of the inventors or producers of those products.

93. To begin to resolve these issues, we turn to the relevant context of Article III:4 of the GATT 1994. In that respect, we observe that Article III:2 of the GATT 1994, which deals with the internal tax treatment of imported and domestic products, prevents Members, through its first sentence, from imposing internal taxes on imported products "in excess of those applied ... to like domestic products." (emphasis added) In previous Reports, we have held that the scope of "like" products in this sentence is to be construed "narrowly".<sup>64</sup> This reading of "like" in Article III:2 might be taken to suggest a similarly narrow reading of "like" in Article III:4, since both provisions form part of the same Article. However, both of these paragraphs of Article III constitute specific expressions of the overarching, "general principle", set forth in Article III:1 of the GATT 1994.<sup>65</sup> As we have previously said, the "general principle" set forth in Article III:1 "informs" the rest of Article III and acts "as a guide to understanding and interpreting the specific obligations contained" in the other paragraphs of Article III, including paragraph 4.<sup>66</sup> Thus, in our view, Article III:1 has particular contextual significance in interpreting Article III:4, as it sets forth the "general principle" pursued by that provision. Accordingly, in interpreting the term "like products" in Article III:4, we must turn, first, to the "general principle" in Article III:1, rather than to the term "like products" in Article III:2.

<sup>63</sup> Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, para. 153.

<sup>64</sup> Appellate Body Report, *Japan – Alcoholic Beverages*, *supra*, footnote 58, at 112 and 113. See, also, Appellate Body Report, *Canada – Periodicals*, *supra*, footnote 48, at 473.

<sup>65</sup> Appellate Body Report, *Japan – Alcoholic Beverages*, *supra*, footnote 58, at 111.

<sup>66</sup> *Ibid.*

94. In addition, we observe that, although the obligations in Articles III:2 and III:4 both apply to "like products", the text of Article III:2 differs in one important respect from the text of Article III:4. Article III:2 contains *two separate* sentences, each imposing *distinct* obligations: the first lays down obligations in respect of "like products", while the second lays down obligations in respect of "directly competitive or substitutable" products.<sup>67</sup> By contrast, Article III:4 applies only to "like products" and does not include a provision equivalent to the second sentence of Article III:2. We note that, in this dispute, the Panel did not examine, at all, the significance of this textual difference between paragraphs 2 and 4 of Article III.

95. For us, this textual difference between paragraphs 2 and 4 of Article III has considerable implications for the meaning of the term "like products" in these two provisions. In *Japan – Alcoholic Beverages*, we concluded, in construing Article III:2, that the two separate obligations in the two sentences of Article III:2 must be interpreted in a harmonious manner that gives meaning to *both* sentences in that provision. We observed there that the interpretation of one of the sentences necessarily affects the interpretation of the other. Thus, the scope of the term "like products" in the first sentence of Article III:2 affects, and is affected by, the scope of the phrase "directly competitive or substitutable" products in the second sentence of that provision. We said in *Japan – Alcoholic Beverages*:

Because the second sentence of Article III:2 provides for a separate and distinctive consideration of the protective aspect of a measure in examining its application to a broader category of products that are not "like products" as contemplated by the first sentence, we agree with the Panel that the first sentence of Article III:2 must be construed narrowly so as not to condemn measures that its strict terms are not meant to condemn. Consequently, we agree with the Panel also that the definition of "like products" in Article III:2, first sentence, should be construed narrowly.<sup>68</sup>

96. In construing Article III:4, the same interpretive considerations do not arise, because the "general principle" articulated in Article III:1 is expressed in Article III:4, not through two distinct obligations, as in the two sentences in Article III:2, but instead through a single obligation that applies solely to "like products". Therefore, the harmony that we have attributed to the two sentences of Article III:2 need not and, indeed, cannot be replicated in interpreting Article III:4. Thus, we conclude that, given the textual difference between Articles III:2 and III:4, the "accordance" of "likeness" stretches in a different way in Article III:4.

<sup>67</sup>The meaning of the second sentence of Article III:2 is elaborated upon in the Interpretative Note to that provision. This note indicates that the second sentence of Article III:2 applies to "directly competitive or substitutable product[s]".

<sup>68</sup>*Supra*, footnote 58, at 112 and 113.

97. We have previously described the "general principle" articulated in Article III:1 as follows:

The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. More specifically, the purpose of Article III "is to ensure that internal measures 'not be applied to imported and domestic products so as to afford protection to domestic production'". Toward this end, Article III obliges Members of the WTO to provide *equality of competitive conditions for imported products in relation to domestic products*. ... Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products. ...<sup>69</sup> (emphasis added)

98. As we have said, although this "general principle" is not explicitly invoked in Article III:4, nevertheless, it "informs" that provision.<sup>70</sup> Therefore, the term "like product" in Article III:4 must be interpreted to give proper scope and meaning to this principle. In short, there must be consonance between the objective pursued by Article III, as enunciated in the "general principle" articulated in Article III:1, and the interpretation of the specific expression of this principle in the text of Article III:4. This interpretation must, therefore, reflect that, in endeavouring to ensure "equality of competitive conditions", the "general principle" in Article III seeks to prevent Members from applying internal taxes and regulations in a manner which affects the competitive relationship, in the marketplace, *between the domestic and imported products involved*, "so as to afford protection to domestic production."

99. As products that are in a competitive relationship in the marketplace could be affected through treatment of *imports* "less favourable" than the treatment accorded to *domestic* products, it follows that the word "like" in Article III:4 is to be interpreted to apply to products that are in such a competitive relationship. Thus, a determination of "likeness" under Article III:4 is, fundamentally, a determination about the nature and extent of a competitive relationship between and among products. In saying this, we are mindful that there is a spectrum of degrees of "competitiveness" or "substitutability" of products in the marketplace, and that it is difficult, if not impossible, in the abstract, to indicate precisely where on this spectrum the word "like" in Article III:4 of the GATT 1994 falls. We are not saying that *all* products which are in *some* competitive relationship are "like products" under Article III:4. In ruling on the measure at issue, we also do not attempt to define the precise scope of the word "like" in Article III:4. Nor do we wish to decide if the scope of "like products" in Article III:4 is co-extensive with the combined scope of "like" and "directly competitive or substitutable" products in Article III:2. However, we recognize that the relationship between these two provisions is important, because there is no sharp distinction between fiscal

<sup>69</sup>Appellate Body Report, *Japan – Alcoholic Beverages*, *supra*, footnote 58, at 109 and 110.

<sup>70</sup>*Ibid.*, at 111.

regulation, covered by Article III:2, and non-fiscal regulation, covered by Article III:4. Both forms of regulation can often be used to achieve the same ends. It would be incongruous if, due to a significant difference in the product scope of these two provisions, Members were prevented from using one form of regulation – for instance, fiscal – to protect domestic production of certain products, but were able to use another form of regulation – for instance, non-fiscal – to achieve those ends. This would frustrate a consistent application of the “general principle” in Article III:1. For these reasons, we conclude that the scope of “like” in Article III:4 is broader than the scope of “like” in Article III:2, first sentence. Nonetheless, we note, once more, that Article III:2 extends not only to “like products”, but also to products which are “directly competitive or substitutable”, and that Article III:4 extends only to “like products”. In view of this different language, and although we need not rule, and do not rule, on the precise product scope of Article III:4, we do conclude that the product scope of Article III:4, although broader than the *first* sentence of Article III:2, is certainly *not* broader than the *combined* product scope of the *two* sentences of Article III:2 of the GATT 1994.

100. We recognize that, by interpreting the term “like products” in Article III:4 in this way, we give that provision a relatively broad product scope – although no broader than the product scope of Article III:2. In so doing, we observe that there is a second element that must be established before a measure can be held to be inconsistent with Article III:4. Thus, even if two products are “like”, that does not mean that a measure is inconsistent with Article III:4. A complaining Member must still establish that the measure accords to the group of “like” imported products “less favourable treatment” than it accords to the group of “like” domestic products. The term “less favourable treatment” expresses the general principle, in Article III:1, that internal regulations “should not be applied ... so as to afford protection to domestic production”. If there is “less favourable treatment” of the group of “like” imported products, there is, conversely, “protection” of the group of “like” domestic products. However, a Member may draw distinctions between products which have been found to be “like”, without, for this reason alone, according to the group of “like” imported products “less favourable treatment” than that accorded to the group of “like” domestic products. In this case, we do not examine further the interpretation of the term “treatment no less favourable” in Article III:4, as the Panel’s findings on this issue have not been appealed or, indeed, argued before us.

### C. Examining the “Likeness” of Products under Article III:4 of the GATT 1994

101. We turn to consideration of how a treaty interpreter should proceed in determining whether products are “like” under Article III:4. As in Article III:2, in this determination, “[i]n]o one approach ... will be appropriate for all cases.”<sup>71</sup> Rather, an assessment utilizing “an unavoidable element of

individual, discretionary judgement”<sup>72</sup> has to be made on a case-by-case basis. The Report of the Working Party on *Border Tax Adjustments* outlined an approach for analyzing “likeness” that has been followed and developed since by several panels and the Appellate Body.<sup>73</sup> This approach has, in the main, consisted of employing four general criteria in analyzing “likeness”: (i) the properties, nature and quality of the products; (ii) the end-uses of the products; (iii) consumers’ tastes and habits – more comprehensively termed consumers’ perceptions and behaviour – in respect of the products; and (iv) the tariff classification of the products.<sup>74</sup> We note that these four criteria comprise four categories of “characteristics” that the products involved might share: (i) the physical properties of the products; (ii) the extent to which the products are capable of serving the same or similar end-uses; (iii) the extent to which consumers perceive and treat the products as alternative means of performing particular functions in order to satisfy a particular want or demand; and (iv) the international classification of the products for tariff purposes.

102. These general criteria, or groupings of potentially shared characteristics, provide a framework for analyzing the “likeness” of particular products on a case-by-case basis. These criteria are, it is well to bear in mind, simply tools to assist in the task of sorting and examining the relevant evidence. They are neither a treaty-mandated nor a closed list of criteria that will determine the legal characterization of products. More important, the adoption of a particular framework to aid in the examination of evidence does not dissolve the duty or the need to examine, in each case, *all* of the pertinent evidence. In addition, although each criterion addresses, in principle, a different aspect of the products involved, which should be examined separately, the different criteria are interrelated. For instance, the physical properties of a product shape and limit the end-uses to which the products can be devoted. Consumer perceptions may similarly influence – modify or even render obsolete – traditional uses of the products. Tariff classification clearly reflects the physical properties of a product.

103. The kind of evidence to be examined in assessing the “likeness” of products will, necessarily, depend upon the particular products and the legal provision at issue. When all the relevant evidence has been examined, panels must determine whether that evidence, as a whole, indicates that the products in question are “like” in terms of the legal provision at issue. We have noted that, under

<sup>72</sup>Appellate Body Report, *Japan – Alcoholic Beverages*, *supra*, footnote 58, at 113.

<sup>73</sup>See further, Appellate Body Report, *Japan – Alcoholic Beverages*, *supra*, footnote 58, at 113 and, in particular, footnote 46. See, also, Panel Report, *United States – Gasoline*, *supra*, footnote 15, para. 6.8, where the approach set forth in the *Border Tax Adjustment* case was adopted in a dispute concerning Article III:4 of the GATT 1994 by a panel. This point was not appealed in that case.

<sup>74</sup>The fourth criterion, tariff classification, was not mentioned by the Working Party on *Border Tax Adjustments*, but was included by subsequent panels (see, for instance, *EEC – Animal Feed*, *supra*, footnote 58, para. 4.2, and *1987 Japan – Alcoholic Beverages*, *supra*, footnote 58, para. 5.6).

Article III:4 of the GATT 1994, the term "like products" is concerned with competitive relationships between and among products. Accordingly, whether the *Border Tax Adjustments* framework is adopted or not, it is important under Article III:4 to take account of evidence which indicates whether, and to what extent, the products involved are – or could be – in a competitive relationship in the marketplace.

D. *The Panel's Findings and Conclusions on "Likeness" under Article III:4 of the GATT 1994*

I. Overview

104. In this case, the European Communities argues that the Panel erred in its consideration of "likeness", in particular, because it adopted an exclusively "commercial or market access approach" to the comparison of allegedly "like products"; placed excessive reliance on a single criterion, namely, end-use; and failed to include consideration of the health "risk" factors relating to asbestos.<sup>75</sup>

105. Before considering these arguments, we think it helpful to summarize the way in which the Panel assessed the "likeness" of *chrysotile asbestos fibres*, on the one hand, and the *PCG fibres* – PVA, cellulose and glass fibres – on the other. It will be recalled that the Panel adopted the approach in the *Border Tax Adjustments* report, using the four general criteria mentioned above.<sup>76</sup> After reviewing the *first* criterion, "properties, nature and quality of the products", the Panel "conclude[d] that ... chrysotile fibres are like PVA, cellulose and glass fibres."<sup>77</sup> (emphasis added) In reaching this "conclusion", the Panel found that it was not decisive that the products "do not have the same structure or chemical composition", nor that asbestos is "unique". Instead, the Panel focused on "market access" and whether the products have the "same applications" and can "replace" each other for some industrial uses.<sup>78</sup> The Panel also declined to "[i]ntroduce a criterion on the risk of a product".<sup>79</sup>

106. Under the second criterion, "end-use", the Panel stated that it had already found, under the first criterion, that the products have "certain identical or at least similar end-uses" and that it did not, therefore, consider it necessary to elaborate further on this criterion.<sup>80</sup> The Panel declined to "take a position" on "consumers' tastes and habits", the third criterion, "[b]ecause this criterion would not

<sup>75</sup>European Communities' other appellant's submission, para. 33.

<sup>76</sup>Panel Report, paras. 8.114 and 8.115.

<sup>77</sup>*Ibid.*, para. 8.126.

<sup>78</sup>*Ibid.*, paras. 8.123, 8.124 and 8.126.

<sup>79</sup>*Ibid.*, para. 8.130.

<sup>80</sup>*Ibid.*, para. 8.136.

provide clear results".<sup>81</sup> The Panel observed that consumers' tastes and habits are "very varied".<sup>82</sup> Finally, the Panel did not regard as "decisive" the different "tariff classification" of the fibres.<sup>83</sup>

107. Based on this reasoning, the Panel concluded that *chrysotile asbestos fibres* and *PCG fibres* are "like products" under Article III:4 of the GATT 1994.<sup>84</sup>

108. The Panel next examined whether *cement-based products containing chrysotile asbestos fibres* are "like" *cement-based products containing PCG fibres*.<sup>85</sup> Applying the reasoning from its findings on fibres, and noting that the individual cement-based products have the same tariff classification, irrespective of their fibre content, the Panel concluded that these cement-based products are also "like" under Article III:4.<sup>86</sup>

2. Chrysotile and PCG fibres

109. In our analysis of this issue on appeal, we begin with the Panel's findings on the "likeness" of *chrysotile asbestos and PCG fibres* and, in particular, with the Panel's overall approach to examining the "likeness" of these fibres. It is our view that, having adopted an approach based on the four criteria set forth in *Border Tax Adjustments*, the Panel should have examined the evidence relating to *each* of those four criteria and, then, weighed *all* of that evidence, along with any other relevant evidence, in making an *overall* determination of whether the products at issue could be characterized as "like". Yet, the Panel expressed a "conclusion" that the products were "like" after examining only the *first* of the four criteria. The Panel then repeated that conclusion under the second criterion – without further analysis – before dismissing altogether the relevance of the third criterion and also before rejecting the differing tariff classifications under the fourth criterion. In our view, it was inappropriate for the Panel to express a "conclusion" after examining only one of the four criteria.<sup>87</sup>

By reaching a "conclusion" without examining all of the criteria it had decided to examine, the Panel, in reality, expressed a conclusion after examining only some of the evidence. Yet, a determination on the "likeness" of products cannot be made on the basis of a partial analysis of the evidence, after examination of just one of the criteria the Panel said it would examine. For this reason, we doubt

<sup>81</sup>Panel Report, para. 8.139.

<sup>82</sup>*Ibid.*

<sup>83</sup>*Ibid.*, para. 8.143.

<sup>84</sup>*Ibid.*, para. 8.144.

<sup>85</sup>*Ibid.*

<sup>86</sup>*Ibid.*, para. 8.150. The Panel devoted six paragraphs to the "likeness" of the cement-based products, whereas it devoted 27 paragraphs to the "likeness" of chrysotile asbestos and PCG fibres.

<sup>87</sup>*Ibid.*, para. 8.126.

whether the Panel's overall approach has allowed the Panel to make a proper characterization of the "likeness" of the fibres at issue.

110. We must next examine more closely the Panel's treatment of the four individual criteria. We see the first criterion, "properties, nature and quality", as intended to cover the physical qualities and characteristics of the products. In analyzing the "properties" of the products, the Panel said that, "because of its physical and chemical characteristics, *asbestos is a unique product*."<sup>88</sup> (emphasis added) The Panel expressly acknowledged that, based on physical properties alone, "[i]t could ... be concluded that [the fibres] are *not* like products."<sup>89</sup> (emphasis added) However, to overcome that fact, the Panel adopted a "market access" approach to this first criterion.<sup>90</sup> Thus, in the course of its examination of "*properties*", the Panel went on to rely on "*end-uses*" – the second criterion – and on the fact that, in a "small number" of cases, the products have the "same applications" and can "replace" each other.<sup>91</sup> The Panel then stated:

We therefore conclude that, taking into account the properties criterion, chrysotile fibres are like PVA, cellulose and glass fibres.<sup>92</sup>

111. We believe that physical properties deserve a separate examination that should not be confused with the examination of end-uses. Although not decisive, the extent to which products share common physical properties may be a useful indicator of "likeness". Furthermore, the physical properties of a product may also influence how the product can be used, consumer attitudes about the product, and tariff classification. It is, therefore, important for a panel to examine fully the physical character of a product. We are also concerned that it will be difficult for a panel to draw the appropriate conclusions from the evidence examined under each criterion if a panel's approach does not clearly address each criterion separately, but rather entwines different, and distinct, elements of the analysis along the way.

112. In addition, we do not share the Panel's conviction that when two products can be used for the same end-use, their "*properties* are then *equivalent*, if not identical."<sup>93</sup> (emphasis added) Products with quite different physical properties may, in some situations, be capable of performing similar or identical end-uses. Although the *end-uses* are then "*equivalent*", the physical properties of the

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<sup>88</sup>Panel Report, para. 8.123.

<sup>89</sup>*Ibid.*, para. 8.121.

<sup>90</sup>*Ibid.*, paras. 8.122 and 8.124.

<sup>91</sup>*Ibid.*, paras. 8.123 and 8.125.

<sup>92</sup>*Ibid.*, para. 8.126.

<sup>93</sup>*Ibid.*, para. 8.125.

products are not thereby altered; they remain different. Thus, the physical "uniqueness" of asbestos that the Panel noted does not change depending on the particular use that is made of asbestos.

113. The European Communities argues that the inquiry into the physical properties of products must include a consideration of the risks posed by the product to human health. In examining the physical properties of the product at issue in this dispute, the Panel found that "it was not appropriate to apply the 'risk' criterion proposed by the EC".<sup>94</sup> The Panel said that to do so "would largely nullify the effect of Article XX(b)" of the GATT 1994.<sup>95</sup> In reviewing this finding by the Panel, we note that neither the text of Article III:4 nor the practice of panels and the Appellate Body suggest that any evidence should be excluded *a priori* from a panel's examination of "likeness". Moreover, as we have said, in examining the "likeness" of products, panels must evaluate *all* of the relevant evidence. We are very much of the view that evidence relating to the health risks associated with a product may be pertinent in an examination of "likeness" under Article III:4 of the GATT 1994. We do not, however, consider that the evidence relating to the health risks associated with chrysotile asbestos fibres need be examined under a *separate* criterion, because we believe that this evidence can be evaluated under the existing criteria of physical properties, and of consumers' tastes and habits, to which we will come below.

114. Panels must examine fully the physical properties of products. In particular, panels must examine those physical properties of products that are likely to influence the competitive relationship between products in the marketplace. In the case of chrysotile asbestos fibres, their molecular structure, chemical composition, and fibrillation capacity are important because the microscopic particles and filaments of chrysotile asbestos fibres are carcinogenic in humans, following inhalation. In this respect, we observe that, at paragraph 8.188 of its Report, the Panel made the following statements regarding chrysotile asbestos fibres:

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<sup>94</sup>Panel Report, para. 8.132.

<sup>95</sup>*Ibid.*, para. 8.130.

... we note that the carcinogenicity of chrysotile fibres has been acknowledged for some time by international bodies.<sup>135</sup> This carcinogenicity was confirmed by the experts consulted by the Panel, with respect to both lung cancers and mesotheliomas, even though the experts appear to acknowledge that chrysotile is less likely to cause mesotheliomas than amphiboles. We also note that the experts confirmed that the types of cancer concerned had a mortality rate of close to 100 per cent. We therefore consider that we have sufficient evidence that there is in fact a serious carcinogenic risk associated with the inhalation of chrysotile fibres. Moreover, in the light of the comments made by one of the experts, the doubts expressed by Canada with respect to the direct effects of chrysotile on mesotheliomas and lung cancers are not sufficient to conclude that an official responsible for public health policy would find that there was not enough evidence of the existence of a public health risk.

<sup>135</sup> Since 1977 by the IARC (see *List of Agents Carcinogenic to Humans, Overall Evaluations of Carcinogenicity to Humans*, Monographs of the International Agency for Research on Cancer, Volumes 1-63), see also WHO, *IPCS Environmental Health Criteria (203) on Chrysotile*, Geneva (1998), cited in para. 5.584 above. On the development of knowledge of the risks associated with asbestos, see Dr. Henderson, para. 5.595.

This carcinogenicity, or toxicity, constitutes, as we see it, a defining aspect of the physical properties of chrysotile asbestos fibres. The evidence indicates that PCG fibres, in contrast, do not share these properties, at least to the same extent.<sup>96</sup> We do not see how this highly significant physical difference *cannot* be a consideration in examining the physical properties of a product as part of a determination of "likeness" under Article III:4 of the GATT 1994.

115. We do not agree with the Panel that considering evidence relating to the health risks associated with a product, under Article III:4, nullifies the effect of Article XX(b) of the GATT 1994. Article XX(b) allows a Member to "adopt and enforce" a measure, *inter alia*, necessary to protect human life or health, even though that measure is inconsistent with another provision of the GATT 1994. Article III:4 and Article XX(b) are distinct and independent provisions of the GATT 1994 each to be interpreted on its own. The scope and meaning of Article III:4 should not be broadened or restricted beyond what is required by the normal customary international law rules of treaty interpretation, simply because Article XX(b) exists and may be available to justify measures inconsistent with Article III:4. The fact that an interpretation of Article III:4, under those rules, implies a less frequent recourse to Article XX(b) does not deprive the exception in Article XX(b) of *effet utile*. Article XX(b) would only be deprived of *effet utile* if that provision could *not* serve to allow a Member to "adopt and enforce" measures "necessary to protect human ... life or health". Evaluating evidence relating to the health risks arising from the physical properties of a product

<sup>96</sup> Panel Report, para. 8.220.

does not prevent a measure which is inconsistent with Article III:4 from being justified under Article XX(b). We note, in this regard, that, different inquiries occur under these two very different Articles. Under Article III:4, evidence relating to health risks may be relevant in assessing the *competitive relationship in the marketplace* between allegedly "like" products. The same, or similar, evidence serves a different purpose under Article XX(b), namely, that of assessing whether a *Member* has a sufficient basis for "adopting or enforcing" a WTO-inconsistent measure on the grounds of human health.

116. We, therefore, find that the Panel erred, in paragraph 8.132 of the Panel Report, in excluding the health risks associated with chrysotile asbestos fibres from its examination of the physical properties of that product.

117. Before examining the Panel's findings under the second and third criteria, we note that these two criteria involve certain of the key elements relating to the competitive relationship between products: first, the extent to which products are capable of performing the same, or similar, functions (end-uses), and, second, the extent to which consumers are willing to use the products to perform these functions (consumers' tastes and habits). Evidence of this type is of particular importance under Article III of the GATT 1994, precisely because that provision is concerned with competitive relationships in the marketplace. If there is – or could be – *no* competitive relationship between products, a Member cannot intervene, through internal taxation or regulation, to protect domestic production. Thus, evidence about the extent to which products can serve the same end-uses, and the extent to which consumers are – or would be – willing to choose one product instead of another to perform those end-uses, is highly relevant evidence in assessing the "likeness" of those products under Article III:4 of the GATT 1994.

118. We consider this to be especially so in cases where the evidence relating to properties establishes that the products at issue are physically quite different. In such cases, in order to overcome this indication that products are *not* "like", a higher burden is placed on complaining Members to establish that, despite the pronounced physical differences, there is a competitive relationship between the products such that *all* of the evidence, taken together, demonstrates that the products are "like" under Article III:4 of the GATT 1994. In this case, where it is clear that the fibres have very different properties, in particular, because chrysotile is a known carcinogen, a very heavy burden is placed on Canada to show, under the second and third criteria, that the chrysotile asbestos and PCG fibres are in such a competitive relationship.

119. With this in mind, we turn to the Panel's evaluation of the second criterion, end-uses. The Panel's evaluation of this criterion is far from comprehensive. First, as we have said, the Panel entwined its analysis of "end-uses" with its analysis of "physical properties" and, in purporting to

examine "end-uses" as a distinct criterion, essentially referred to its analysis of "properties".<sup>97</sup> This makes it difficult to assess precisely how the Panel evaluated the end-uses criterion. Second, the Panel's analysis of end-uses is based on a "small number of applications" for which the products are substitutable. Indeed, the Panel stated that "[i]t suffices that, for a *given utilization*, the properties are the same to the extent that one product can replace the other."<sup>98</sup> (emphasis added) Although we agree that it is certainly relevant that products have similar end-uses for a "small number of ... applications", or even for a "given utilization", we think that a panel must also examine the other, *different* end-uses for products.<sup>99</sup> It is only by forming a complete picture of the various end-uses of a product that a panel can assess the significance of the fact that products share a limited number of end-uses. In this case, the Panel did not provide such a complete picture of the various end-uses of the different fibres. The Panel did not explain, or elaborate in any way on, the "small number of ... applications" for which the various fibres have similar end-uses. Nor did the Panel examine the end-uses for these products which were not similar. In these circumstances, we believe that the Panel did not adequately examine the evidence relating to end-uses.

120. The Panel declined to examine or make any findings relating to the third criterion, consumers' tastes and habits, "[b]ecause this criterion would not provide clear results".<sup>100</sup> There will be few situations where the evidence on the "likeness" of products will lend itself to "clear results". In many cases, the evidence will give conflicting indications, possibly within each of the four criteria. For instance, there may be some evidence of similar physical properties and some evidence of differing physical properties. Or the physical properties may differ completely, yet there may be strong evidence of similar end-uses and a high degree of substitutability of the products from the perspective of the consumer. A panel cannot decline to inquire into relevant evidence simply because it suspects that evidence may not be "clear" or, for that matter, because the parties agree that certain evidence is not relevant.<sup>101</sup> In any event, we have difficulty seeing how the Panel could conclude that an examination of consumers' tastes and habits "would not provide clear results", given that the Panel did not examine *any* evidence relating to this criterion.

121. Furthermore, in a case such as this, where the fibres are physically very different, a panel *cannot* conclude that they are "like products" if it *does not examine* evidence relating to consumers' tastes and habits. In such a situation, if there is *no* inquiry into this aspect of the nature and extent of

<sup>97</sup>Panel Report, para. 8.136.

<sup>98</sup>*Ibid.*, para. 8.124.

<sup>99</sup>*Ibid.*, paras. 8.124 and 8.125.

<sup>100</sup>*Ibid.*, para. 8.139.

<sup>101</sup>In that respect, we note that, at the oral hearing before us, Canada stated that it believed that the parties were in agreement that consideration of consumers' tastes and habits "would add nothing" to the determination of "likeness".

the competitive relationship between the products, there is no basis for overcoming the inference, drawn from the different physical properties of the products, that the products are not "like".

122. In this case especially, we are also persuaded that evidence relating to consumers' tastes and habits would establish that the health risks associated with chrysotile asbestos fibres influence consumers' behaviour with respect to the different fibres at issue.<sup>102</sup> We observe that, as regards *chrysotile asbestos and PCG fibres*, the consumer of the fibres is a *manufacturer* who incorporates the fibres into another product, such as cement-based products or brake linings. We do not wish to speculate on what the evidence regarding these consumers would have indicated; rather, we wish to highlight that consumers' tastes and habits regarding *fibres*, even in the case of commercial parties, such as manufacturers, are very likely to be shaped by the health risks associated with a product which is known to be highly carcinogenic.<sup>103</sup> A manufacturer cannot, for instance, ignore the preferences of the ultimate consumer of its products. If the risks posed by a particular product are sufficiently great, the ultimate consumer may simply cease to buy that product. This would, undoubtedly, affect a manufacturer's decisions in the marketplace. Moreover, in the case of products posing risks to human health, we think it likely that manufacturers' decisions will be influenced by other factors, such as the potential civil liability that might flow from marketing products posing a health risk to the ultimate consumer, or the additional costs associated with safety procedures required to use such products in the manufacturing process.

123. Finally, we note that, although we consider consumers' tastes and habits significant in determining "likeness" in this dispute, at the oral hearing, Canada indicated that it considers this criterion to be *irrelevant*, in this dispute, because the existence of the measure has disturbed normal conditions of competition between the products. In our Report in *Korea – Alcoholic Beverages*, we observed that, "[p]articularly in a market where there are regulatory barriers to trade or to competition, there may well be latent demand" for a product.<sup>104</sup> We noted that, in such situations, "it may be highly relevant to examine latent demand" that is suppressed by regulatory barriers.<sup>105</sup> In addition, we said that "evidence from other markets may be pertinent to the examination of the market at issue, particularly when demand on that market has been influenced by regulatory barriers to trade or to

<sup>102</sup>We have already noted the health risks associated with chrysotile asbestos fibres in our consideration of properties (*supra*, para. 114).

<sup>103</sup>We recognize that consumers' reactions to products posing a risk to human health vary considerably depending on the product, and on the consumer. Some dangerous products, such as tobacco, are widely used, despite the known health risks. The influence known dangers have on consumers' tastes and habits is, therefore, unlikely to be uniform or entirely predictable.

<sup>104</sup>*Supra*, footnote 58, para. 115.

<sup>105</sup>*Ibid.*, para. 120. We added that "studies of cross-price elasticity ... involve an assessment of latent demand" (para. 121).

competition."<sup>106</sup> We, therefore, do not accept Canada's contention that, in markets where normal conditions of competition have been disturbed by regulatory or fiscal barriers, consumers' tastes and habits cease to be relevant. In such situations, a Member may submit evidence of latent, or suppressed, consumer demand in that market, or it may submit evidence of substitutability from some relevant third market. In making this point, we do not wish to be taken to suggest that there *is* latent demand for chrysotile asbestos fibres. Our point is simply that the existence of the measure does not render consumers' tastes and habits irrelevant, as Canada contends.

124. We observe also that the Panel did not regard as decisive the different tariff classifications of the chrysotile asbestos, PVA, cellulose and glass fibres, each of which is classified under a different tariff heading.<sup>107</sup> In the absence of a full analysis, by the Panel, of the other three criteria addressed, we cannot determine what importance should be attached to the different tariff classifications of the fibres.

125. In sum, in our view, the Panel reached the conclusion that *chrysotile asbestos and PCG fibres* are "like products" under Article III:4 of the GATT 1994 on the following basis: the Panel disregarded the quite different "properties, nature and quality" of chrysotile asbestos and PCG fibres, as well as the different tariff classification of these fibres; it considered no evidence on consumers' tastes and habits; and it found that, for a "small number" of the many applications of these fibres, they are substitutable, but it did not consider the many other end-uses for the fibres that are different. Thus, the only evidence supporting the Panel's finding of "likeness" is the "small number" of shared end-uses of the fibres.

126. For the reasons we have given, we find this insufficient to justify the conclusion that the chrysotile asbestos and PCG fibres are "like products" and we, therefore, reverse the Panel's conclusion, in paragraph 8.144 of the Panel Report, "that chrysotile fibres, on the one hand, and PVA, cellulose and glass fibres, on the other, are 'like products' within the meaning of Article III:4 of the GATT 1994."

3. Cement-based products containing chrysotile and PCG fibres

127. Having reversed the Panel's finding on the "likeness" of the *fibres*, we now examine the Panel's findings regarding the "likeness" of *cement-based products containing chrysotile asbestos fibres* and *cement-based products containing PCG fibres*. In examining the "likeness" of these cement-based products, the Panel stated that, physically, the only difference between these products is

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<sup>106</sup>*Supra*, footnote 58, para. 137.

<sup>107</sup>Panel Report, para. 8.143.

the incorporation of a different fibre.<sup>108</sup> In this respect, the Panel indicated that "many of the arguments put forward in relation to chrysotile asbestos, PVA, cellulose and glass fibres are applicable *mutatis mutandis* to products containing those fibres."<sup>109</sup> The Panel noted that, for any given cement-based product, the tariff classification is the same, irrespective of the fibre incorporated into the product.<sup>110</sup> The Panel declined to examine the "risk" criterion advanced by the European Communities, and also considered it unnecessary to analyze consumers' tastes and habits.<sup>111</sup> On this basis, the Panel concluded that "chrysotile-fibre products and fibro-cement products are like products within the meaning of Article III:4 of the GATT 1994."<sup>112</sup>

128. As the Panel said, the primary physical difference between cement-based products containing chrysotile asbestos fibres and cement-based products containing PCG fibres lies in the particular fibre incorporated into the product. This difference is important because, as we have said in our examination of fibres, we believe that the health risks associated with a product may be relevant to the inquiry into the physical properties of a product when making a determination of "likeness" under Article III:4 of the GATT 1994.<sup>113</sup> This is also true for cement-based products containing the different fibres. In examining the *physical properties* of the two sets of cement-based products, it cannot be ignored that one set of products contains a fibre known to be highly carcinogenic, while the other does not.<sup>114</sup> In this respect, we recall that the Panel concluded that "there is an undeniable public health risk in relation to chrysotile contained in high-density chrysotile-cement products."<sup>115</sup> We, therefore, reverse the Panel's finding, in paragraph 8.149 of the Panel Report, that these health risks are not relevant in examining the "likeness" of the cement-based products.

129. Furthermore, the Panel did not indicate whether or to what extent the incorporation of one type of fibre, instead of another, affects other physical properties of a particular cement-based product and, consequently, affects the suitability of that product for a specific *end-use*. The Panel noted that the fibres give the products their specific function – "mechanical strength, resistance to heat, compression, etc." – but the Panel did not examine the extent to which the presence of a particular

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<sup>108</sup>Panel Report, para. 8.145.

<sup>109</sup>*Ibid.*

<sup>110</sup>*Ibid.*, para. 8.148.

<sup>111</sup>*Ibid.*, para. 8.149.

<sup>112</sup>*Ibid.*, para. 8.150.

<sup>113</sup>*Supra*, para. 113.

<sup>114</sup>*Supra*, para. 114.

<sup>115</sup>Panel Report, para. 8.203.

fibre affects the ability of a cement-based product to perform one or more of these functions efficiently.<sup>116</sup>

130. In addition, even if the cement-based products were functionally interchangeable, we consider it likely that the presence of a known carcinogen in one of the products would have an influence on *consumers' tastes and habits* regarding that product. We believe this to be true irrespective of whether the consumer of the *cement-based* products is a commercial party, such as a construction company, or is an individual, for instance, a do-it-yourself ("DIY") enthusiast or someone who owns or lives or works in a building. This influence may well vary, but the possibility of such an influence should not be overlooked by a panel when considering the "likeness" of products containing chrysotile asbestos. In the absence of an examination of consumers' tastes and habits, we do not see how the Panel could reach a conclusion on the "likeness" of the cement-based products at issue.<sup>117</sup>

131. For all of these reasons, we reverse the Panel's conclusion, in paragraph 8.150 of the Panel Report, "that chrysotile-fibre products and fibro-cement products are like products within the meaning of Article III:4 of the GATT 1994."

132. As we have reversed the Panel's findings that chrysotile asbestos fibres and PCG fibres are "like products" under Article III:4 of the GATT 1994, and also the Panel's findings that cement-based products containing chrysotile asbestos fibres and cement-based products containing PCG fibres are "like products" under that provision, we also reverse, in consequence, the Panel's conclusion, in paragraph 8.158 of the Panel Report, that the measure is inconsistent with Article III:4 of the GATT 1994 as this finding rests, in part, on the Panel's findings that the two sets of products are "like".

E. *Completing the "Like Product" Analysis under Article III:4 of the GATT 1994*

133. As we have reversed both of the Panel's conclusions on "likeness" under Article III:4 of the GATT 1994, we think it appropriate to complete the analysis, on the basis of the factual findings of the Panel and of the undisputed facts in the Panel record. We have already examined the meaning of the term "like products", and we have also approved the approach for inquiring into "likeness" that is based on the Report of the Working Party in *Border Tax Adjustments* and that was also approved, though not entirely followed, by the Panel in this case. Under that approach, the evidence is to be examined under four criteria: physical properties; end-uses; consumers' tastes and habits; and tariff classification.

<sup>116</sup>Panel Report, para. 8.145.

<sup>117</sup>See, further, *supra*, paras. 117 and 118. See, also, *supra*, paras. 121 and 122.

I. Chrysotile and PCG fibres

134. We address first the "likeness" of *chrysotile asbestos fibres* and *PCG fibres*. As regards the physical properties of these fibres, we recall that the Panel stated that:

The Panel notes that no party contests that the structure of chrysotile fibres is unique by nature and in comparison with artificial fibres that can replace chrysotile asbestos. The parties agree that none of the substitute fibres mentioned by Canada in connection with Article III:4 has the same structure, either in terms of its form, its diameter, its length or its potential to release particles that possess certain characteristics. Moreover, they do not have the same chemical composition, which means that, in purely physical terms, none of them has the same nature or quality.<sup>118</sup>

135. We also see it as important to take into account that, since 1977, chrysotile asbestos fibres have been recognized internationally as a known carcinogen because of the particular combination of their molecular structure, chemical composition, and fibrillation capacity.<sup>119</sup> In that respect, the Panel noted that:

... the carcinogenicity of chrysotile fibres has been acknowledged for some time by international bodies. This carcinogenicity was confirmed by the experts consulted by the Panel, with respect to both lung cancers and mesotheliomas, even though the experts appear to acknowledge that chrysotile is less likely to cause mesotheliomas than amphiboles. We also note that the experts confirmed that the types of cancer concerned had a mortality rate of close to 100 per cent. We therefore consider that we have sufficient evidence that there is in fact a serious carcinogenic risk associated with the inhalation of chrysotile fibres.<sup>120</sup>

In contrast, the Panel found that the PCG fibres "are not classified by the WHO at the same level of risk as chrysotile."<sup>121</sup> The experts also confirmed, as the Panel reported, that current scientific evidence indicates that PCG fibres do "not present the same risk to health as chrysotile" asbestos fibres.<sup>122</sup>

136. It follows that the evidence relating to properties indicates that, physically, chrysotile asbestos and PCG fibres are very different. As we said earlier, in such cases, in order to overcome this indication that products are *not* "like", a high burden is imposed on a complaining Member to

<sup>118</sup>Panel Report, para. 8.121.

<sup>119</sup>*Supra*, para. 114.

<sup>120</sup>Panel Report, para. 8.188.

<sup>121</sup>*Ibid.*, para. 8.220.

<sup>122</sup>*Ibid.*

establish that, despite the pronounced physical differences, there is a competitive relationship between the products such that, *all* of the evidence, taken together, demonstrates that the products are "like" under Article III:4 of the GATT 1994.

137. The Panel observed that the end-uses of chrysotile asbestos and PCG fibres are the same "for a small number" of applications.<sup>123</sup> The Panel simply adverted to these overlapping end-uses and offered no elaboration on their nature and character. We note that Canada argued before the Panel that there are some 3,000 commercial applications for asbestos fibres.<sup>124</sup> Canada and the European Communities indicated that the most important end-uses for asbestos fibres include, in no particular order, incorporation into: cement-based products; insulation; and various forms of friction lining.<sup>125</sup> Canada noted that 90 percent, by quantity, of French imports of chrysotile asbestos were used in the production of cement-based products.<sup>126</sup> This evidence suggests that chrysotile asbestos and PCG fibres share a small number of similar end-uses and, that, as Canada asserted, for chrysotile asbestos, these overlapping end-uses represent an important proportion of the end-uses made of chrysotile asbestos, measured in terms of quantity.

138. There is, however, no evidence on the record regarding the nature and extent of the many end-uses for chrysotile asbestos and PCG fibres which are *not* overlapping. Thus, we do not know what proportion of all end-uses for chrysotile asbestos and PCG fibres overlap. Where products have a wide range of end-uses, only some of which overlap, we do not believe that it is sufficient to rely solely on evidence regarding the overlapping end-uses, without also examining evidence of the nature and importance of these end-uses in relation to all of the other possible end-uses for the products. In the absence of such evidence, we cannot determine the significance of the fact that chrysotile asbestos and PCG fibres share a small number of similar end-uses.

139. As we have already stated, Canada took the view, both before the Panel and before us, that consumers' tastes and habits have no relevance to the inquiry into the "likeness" of the fibres.<sup>127</sup> We have already addressed, and dismissed, the arguments advanced by Canada in support of this contention.<sup>128</sup> We have also stated that, in a case such as this one, where the physical properties of the fibres are very different, an examination of the evidence relating to consumers' tastes and habits is an indispensable – although not, on its own, sufficient – aspect of any determination that products are

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<sup>123</sup>Panel Report, para. 8.125.

<sup>124</sup>*Ibid.*, para. 3.21.

<sup>125</sup>*Ibid.*, paras. 3.21 (Canada) and 3.23 (European Communities). The lists of important uses given by the parties is not identical in all respects and we have distilled from each list the common elements.

<sup>126</sup>Panel Report, para. 3.21, footnote 7.

<sup>127</sup>*Supra*, paras. 120 and 123.

<sup>128</sup>*Ibid.*

"like" under Article III:4 of the GATT 1994.<sup>129</sup> If there is no evidence on this aspect of the nature and extent of the competitive relationship between the fibres, there is no basis for overcoming the inference, drawn from the different physical properties, that the products are not "like". However, in keeping with its argument that this criterion is irrelevant, Canada presented *no* evidence on consumers' tastes and habits regarding chrysotile asbestos and PCG fibres.<sup>130</sup>

140. Finally, we note that chrysotile asbestos fibres and the various PCG fibres all have different tariff classifications. While this element is not, on its own, decisive, it does tend to indicate that chrysotile and PCG fibres are not "like products" under Article III:4 of the GATT 1994.

141. Taken together, in our view, all of this evidence is certainly far from sufficient to satisfy Canada's burden of proving that chrysotile asbestos fibres are "like" PCG fibres under Article III:4 of the GATT 1994. Indeed, this evidence rather tends to suggest that these products are not "like products" for the purposes of Article III:4 of the GATT 1994.

## 2. Cement-based products containing chrysotile and PCG fibres

142. We turn next to consider whether *cement-based products containing chrysotile asbestos fibres* are "like" *cement-based products containing PCG fibres* under Article III:4 of the GATT 1994. We begin, once again, with physical properties. In terms of composition, the physical properties of the different cement-based products appear to be relatively similar. Yet, there is one principal and significant difference between these products: one set of cement-based products contains a known carcinogenic fibre, while the other does not. The Panel concluded that the presence of chrysotile asbestos fibres in cement-based products poses "an undeniable public health risk".<sup>131</sup>

143. The Panel stated that the fibres give the cement-based products their specific function – "mechanical strength, resistance to heat, compression, etc."<sup>132</sup> These functions are clearly based on the physical properties of the products. There is no evidence of record to indicate whether the presence of chrysotile asbestos fibres, rather than PCG fibres, in a particular cement-based product, affects these particular physical properties of the products. For instance, a tile incorporating chrysotile asbestos fibres may be more heat resistant than a tile incorporating a PCG fibre.

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<sup>129</sup>Our reasons for reaching this conclusion are set forth, *supra*, in paras. 117, 118, 121 and 122.

<sup>130</sup>Canada did present evidence that the impact of the Decree was to reduce demand for chrysotile (Panel Report, paras. 3.20 and 3.422). However, as Canada recognized, this is a necessary consequence of the prohibition on chrysotile and is not evidence of consumers' attitudes and choices regarding the products at issue. As we have said, regulatory measures *may* suppress latent consumer demand for a product (*supra*, para. 123).

<sup>131</sup>Panel Report, para. 8.203.

<sup>132</sup>*Ibid.*, para. 8.145.

144. In addition, there is no evidence to indicate to what extent the incorporation of one type of fibre, instead of another, affects the suitability of a particular cement-based product for a specific end-use.<sup>133</sup> Once again, it may be that tiles containing chrysotile asbestos fibres perform some end-uses, such as resistance to heat, more efficiently than tiles containing a PCG fibre. Thus, while we accept that the two different types of cement-based products may perform largely similar end-uses, in the absence of evidence, we cannot determine whether each type of cement-based product can perform, with *equal* efficiency, *all* of the functions performed by the other type of cement-based product.

145. As with the fibres, Canada contends that evidence on consumers' tastes and habits concerning cement-based products is irrelevant. Accordingly, Canada submitted no such evidence to the Panel. We have dismissed Canada's arguments in support of this contention.<sup>134</sup> We have also indicated that it is of particular importance, under Article III of the GATT 1994, to examine evidence relating to competitive relationships in the marketplace.<sup>135</sup> We consider it likely that the presence of a known carcinogen in one of the products will have an influence on consumers' tastes and habits regarding that product.<sup>136</sup> It may be, for instance, that, although cement-based products containing chrysotile asbestos fibres are capable of performing the same functions as other cement-based products, consumers are, to a greater or lesser extent, not willing to use products containing chrysotile asbestos fibres because of the health risks associated with them. Yet, this is only speculation; the point is, there is no evidence. We are of the view that a determination on the "likeness" of the cement-based products cannot be made, under Article III:4, in the absence of an examination of evidence on consumers' tastes and habits. And, in this case, no such evidence has been submitted.

146. As regards tariff classification, we observe that, for any given cement-based product, the tariff classification of the product is the same.<sup>137</sup> However, this indication of "likeness" cannot, on its own, be decisive.

147. Thus, we find that, in particular, in the absence of any evidence concerning consumers' tastes and habits, Canada has not satisfied its burden of proving that cement-based products containing chrysotile asbestos fibres are "like" cement-based products containing PCG fibres, under Article III:4 of the GATT 1994.

148. As Canada has not demonstrated either that chrysotile asbestos fibres are "like" PCG fibres, or that cement-based products containing chrysotile asbestos fibres are "like" cement-based products

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<sup>133</sup> *Supra*, para. 129.

<sup>134</sup> *Supra*, paras. 120 and 123.

<sup>135</sup> *Supra*, para. 117.

<sup>136</sup> *Supra*, para. 130.

<sup>137</sup> Panel Report, para. 8.148.

containing PCG fibres, we conclude that Canada has not succeeded in establishing that the measure at issue is inconsistent with Article III:4 of the GATT 1994.

149. One Member of the Division hearing this appeal wishes to make a concurring statement. At the outset, I would like to make it abundantly clear that I agree with the findings and conclusions reached, and the reasoning set out in support thereof, by the Division, in: Section V (*TBT Agreement*); Section VII (Article XX(b) of the GATT 1994 and Article 11 of the DSU); Section VIII (Article XXIII:1(b) of the GATT 1994); and Section IX (Findings and Conclusions) of the Report. This concurring statement, in other words, relates only to Section VI ("Like Products" in Article III:4 of the GATT 1994) of the Report.

150. More particularly, in respect of Section VI of the Report, I join in the findings and conclusions set out in: paragraphs 116, 126, 128, 131, 132, 141, 147 and 148. I am bound to say that, in truth, I agree with a great deal more than just the bare findings and conclusions contained in these eight paragraphs of the Report. It is, however, as a practical matter, not feasible to sort out and identify which part of which paragraph, of the sixty-odd paragraphs comprising Section VI of our Report in which I join. Nor is it feasible to offer a detailed statement with respect to the portions that would then remain. Accordingly, I set out only two related matters below.

151. In paragraph 113 of the Report, we state that "[w]e are very much of the view that evidence relating to the health risks associated with a product may be pertinent in an examination of 'likeness' under Article III:4 of the GATT 1994." We also point out, in paragraph 114, that "[p]anelists must examine fully the physical properties of products. In particular, ... those physical properties of products that are likely to influence the competitive relationship between products in the market place. In the cases of chrysotile asbestos fibres, their molecular structure, chemical composition, and fibrillation capacity are important because the microscopic particles and filaments of chrysotile asbestos fibres are carcinogenic in humans, following inhalation." This carcinogenicity we describe as "a defining aspect of the physical properties of chrysotile asbestos fibres"<sup>138</sup>, which property is not shared by the PCG fibres, "at least to the same extent."<sup>139</sup> We express our inability to "see how this highly significant physical difference *cannot* be a consideration in examining the physical properties of a product as part of a determination of 'likeness' under Article III:4 of the GATT 1994."<sup>140</sup> (emphasis in the original) We observe also that the Panel, after noting that the carcinogenicity of chrysotile asbestos fibres has been acknowledged by international bodies and confirmed by the experts the Panel consulted, ruled that it "[has] sufficient evidence that *there is in fact a serious*

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<sup>138</sup> *Supra*, para. 114.

<sup>139</sup> *Ibid.*

<sup>140</sup> *Ibid.*

*carcinogenic risk associated with the inhalation of chrysotile fibres.*"<sup>141</sup> (emphasis added) In fact, the scientific evidence of record for this finding of carcinogenicity of chrysotile asbestos fibres is so clear, voluminous, and is confirmed, a number of times, by a variety of international organizations, as to be practically overwhelming.

152. In the present appeal, considering the nature and quantum of the scientific evidence showing that the physical properties and qualities of chrysotile asbestos fibres include or result in carcinogenicity, my submission is that there is ample basis for a definitive characterization, on completion of the legal analysis, of such fibres as *not* "like" PCG fibres. PCG fibres, it may be recalled, have not been shown by Canada to have the same lethal properties as chrysotile asbestos fibres. That definitive characterization, it is further submitted, may and should be made even in the absence of evidence concerning the other two *Border Tax Adjustments* criteria (categories of "potentially shared characteristics") of end-uses and consumers' tastes and habits. It is difficult for me to imagine what evidence relating to economic competitive relationships as reflected in end-uses and consumers' tastes and habits could outweigh and set at naught the undisputed deadly nature of chrysotile asbestos fibres, compared with PCG fibres, when inhaled by humans, and thereby compel a characterization of "likeness" of chrysotile asbestos and PCG fibres.

153. The suggestion I make is not that *any* kind or degree of health risk, associated with a particular product, would *a priori* negate a finding of the "likeness" of that product with another product, under Article III:4 of the GATT 1994. The suggestion is a very narrow one, limited only to the circumstances of this case, and confined to chrysotile asbestos fibres as compared with PCG fibres. To hold that these fibres are not "like" one another in view of the undisputed carcinogenic nature of chrysotile asbestos fibres appears to me to be but a small and modest step forward from mere reversal of the Panel's ruling that chrysotile asbestos and PCG fibres are "like", especially since our holding in completing the analysis is that Canada failed to satisfy a complainant's burden of proving that PCG fibres are "like" chrysotile asbestos fibres under Article III:4. That small step, however, the other Members of the Division feel unable to take because of their conception of the "fundamental", perhaps decisive, role of economic competitive relationships in the determination of the "likeness" of products under Article III:4.

154. My second point is that the necessity or appropriateness of adopting a "fundamentally" economic interpretation of the "likeness" of products under Article III:4 of the GATT 1994 does not appear to me to be free from substantial doubt. Moreover, in future concrete contexts, the line between a "fundamentally" and "exclusively" economic view of "like products" under Article III:4 may well prove very difficult, as a practical matter, to identify. It seems to me the better part of

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<sup>141</sup>Panel Report, para. 8.188. See, *supra*, para. 114.

valour to reserve one's opinion on such an important, indeed, philosophical matter, which may have unforeseeable implications, and to leave that matter for another appeal and another day, or perhaps other appeals and other days. I so reserve my opinion on this matter.

## VII. Article XX(b) of the GATT 1994 and Article 11 of the DSU

155. Under Article XX(b) of the GATT 1994, the Panel examined, first, whether the use of chrysotile-cement products poses a risk to human health and, second, whether the measure at issue is "necessary to protect human ... life or health". Canada contends that the Panel erred in law in its findings on both these issues. We will examine these two issues in turn before addressing Canada's appeal that the Panel failed to make an "objective assessment", under Article 11 of the DSU, in reaching its conclusions under Article XX(b) of the GATT 1994.

156. We recall that Article XX(b) of the GATT 1994 reads:

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 Member of *measures*:

...

(b) *necessary to protect human, animal or plant life or health; (emphasis added)*

...

A. *"To Protect Human Life or Health"*

157. On the issue of whether the use of chrysotile-cement products poses a risk to human health sufficient to enable the measure to fall within the scope of application of the phrase "to protect human ... life or health" in Article XX(b), the Panel stated that it "considers that the evidence before it *tends to show* that handling chrysotile-cement products constitutes a risk to health rather than the opposite."<sup>142</sup> (emphasis added) On the basis of this assessment of the evidence, the Panel concluded that:

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<sup>142</sup>Panel Report, para. 8.193.

... the EC has made a prima facie case for the existence of a health risk in connection with the use of chrysotile, in particular as regards lung cancer and mesothelioma in the occupational sectors downstream of production and processing and for the public in general in relation to chrysotile-cement products. This prima facie case has not been rebutted by Canada. Moreover, the Panel considers that the comments by the experts confirm the health risk associated with exposure to chrysotile in its various uses. *The Panel therefore considers that the EC have shown that the policy of prohibiting chrysotile asbestos implemented by the Decree falls within the range of policies designed to protect human life or health.* ...<sup>143</sup> (emphasis added)

Thus, the Panel found that the measure falls within the category of measures embraced by Article XX(b) of the GATT 1994.

158. According to Canada, the Panel deduced that there was a risk to human life or health associated with manipulation of chrysotile-cement products from seven factors.<sup>144</sup> These seven factors all relate to the scientific evidence which was before the Panel, including the opinion of the scientific experts. Canada argues that the Panel erred in law by deducing from these seven factors that chrysotile-cement products pose a risk to human life or health.<sup>145</sup>

159. Although Canada does not base its arguments about these seven factors on Article 11 of the DSU, we bear in mind the discretion that is enjoyed by panels as the trier of facts. In *United States – Wheat Gluten*, we said:

... in view of the distinction between the respective roles of the Appellate Body and panels, we have taken care to emphasize that a panel's appreciation of the evidence falls, in principle, "within the scope of the panel's discretion as the trier of facts". (emphasis added)

In assessing the panel's appreciation of the evidence, we cannot base a finding of inconsistency under Article 11 simply on the conclusion that we might have reached a different factual finding from the one the panel reached. Rather, we must be satisfied that the panel has exceeded the bounds of its discretion, as the trier of facts, in its appreciation of the evidence. As is clear from previous appeals, we will not interfere lightly with the panel's exercise of its discretion.<sup>146</sup>

160. In *Korea – Alcoholic Beverages*, we were faced with arguments that sought to cast doubt on certain studies relied on by the panel in that case. We stated:

<sup>143</sup>Panel Report, para. 8.194.

<sup>144</sup>Canada's appellant's submission, para. 170. The seven factors Canada relies upon are identified in para. 19 of this Report.

<sup>145</sup>Canada's appellant's submission, para. 171.

<sup>146</sup>*Supra*, footnote 48, para. 151.

The Panel's examination and weighing of the evidence submitted fall, in principle, within the scope of the Panel's discretion as the trier of facts and, accordingly, outside the scope of appellate review. This is true, for instance, with respect to the Panel's treatment of the Dodwell Study, the Sofres Report and the Nielsen Study. *We cannot second-guess the Panel in appreciating either the evidentiary value of such studies or the consequences, if any, of alleged defects in those studies.* Similarly, it is not for us to review the relative weight ascribed to evidence on such matters as marketing studies ...<sup>147</sup> (emphasis added)

161. The same holds true in this case. The Panel enjoyed a margin of discretion in assessing the value of the evidence, and the weight to be ascribed to that evidence. The Panel was entitled, in the exercise of its discretion, to determine that certain elements of evidence should be accorded more weight than other elements – that is the essence of the task of appreciating the evidence.

162. With this in mind, we have examined the seven factors on which Canada relies in asserting that the Panel erred in concluding that there exists a human health risk associated with the manipulation of chrysotile-cement products. We see Canada's appeal on this point as, in reality, a challenge to the Panel's assessment of the credibility and weight to be ascribed to the scientific evidence before it. Canada contests the conclusions that the Panel drew both from the evidence of the scientific experts and from scientific reports before it. As we have noted, we will interfere with the Panel's appreciation of the evidence only when we are "satisfied that the panel has exceeded the bounds of its discretion, as the trier of facts, in its appreciation of the evidence."<sup>148</sup> (emphasis added)

In this case, nothing suggests that the Panel exceeded the bounds of its lawful discretion. To the contrary, all four of the scientific experts consulted by the Panel concurred that chrysotile asbestos fibres, and chrysotile-cement products, constitute a risk to human health, and the Panel's conclusions on this point are faithful to the views expressed by the four scientists. In addition, the Panel noted that the carcinogenic nature of chrysotile asbestos fibres has been acknowledged since 1977 by international bodies, such as the International Agency for Research on Cancer and the World Health Organization.<sup>149</sup> In these circumstances, we find that the Panel remained well within the bounds of its discretion in finding that chrysotile-cement products pose a risk to human life or health.

163. Accordingly, we uphold the Panel's finding, in paragraph 8.194 of the Panel Report, that the measure "protect[s] human ... life or health", within the meaning of Article XX(b) of the GATT 1994.

<sup>147</sup>*Supra*, footnote 58, para. 161.

<sup>148</sup>Appellate Body Report, *United States – Wheat Gluten*, *supra*, footnote 48, para. 151.

<sup>149</sup>Panel Report, para. 8.188.

B. "Necessary"

164. On the issue of whether the measure at issue is "necessary" to protect public health within the meaning of Article XX(b), the Panel stated:

In the light of France's public health objectives as presented by the European Communities, the Panel concludes that the EC has made a *prima facie* case for the non-existence of a reasonably available alternative to the banning of chrysotile and chrysotile-cement products and recourse to substitute products. Canada has not rebutted the presumption established by the EC. We also consider that the EC's position is confirmed by the comments of the experts consulted in the course of this proceeding.<sup>150</sup>

165. Canada argues that the Panel erred in applying the "necessity" test under Article XX(b) of the GATT 1994 "by stating that there is a high enough risk associated with the manipulation of chrysotile-cement products that it could in principle justify strict measures such as the Decree."<sup>151</sup> Canada advances four arguments in support of this part of its appeal. First, Canada argues that the Panel erred in finding, on the basis of the scientific evidence before it, that chrysotile-cement products pose a risk to human health.<sup>152</sup> Second, Canada contends that the Panel had an obligation to "quantify" itself the risk associated with chrysotile-cement products and that it could not simply "rely" on the "hypotheses" of the French authorities.<sup>153</sup> Third, Canada asserts that the Panel erred by postulating that the level of protection of health inherent in the Decree is a halt to the spread of asbestos-related health risks. According to Canada, this "premise is false because it does not take into account the risk associated with the use of substitute products without a framework for controlled use."<sup>154</sup> Fourth, and finally, Canada claims that the Panel erred in finding that "controlled use" is not a reasonably available alternative to the Decree.

166. With respect to Canada's first argument, we note simply that we have already dismissed Canada's contention that the evidence before the Panel did not support the Panel's findings.<sup>155</sup> We are satisfied that the Panel had a more than sufficient basis to conclude that chrysotile-cement products do pose a significant risk to human life or health.

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<sup>150</sup>Panel Report, para. 8.222.

<sup>151</sup>Canada's appellant's submission, para. 187.

<sup>152</sup>*Ibid.*, paras. 188 and 189.

<sup>153</sup>*Ibid.*, para. 193.

<sup>154</sup>*Ibid.*, para. 195.

<sup>155</sup>*Supra*, paras. 159-163.

167. As for Canada's second argument, relating to "quantification" of the risk, we consider that, as with the *SPS Agreement*, there is no requirement under Article XX(b) of the GATT 1994 to *quantify*, as such, the risk to human life or health.<sup>156</sup> A risk may be evaluated either in quantitative or qualitative terms. In this case, contrary to what is suggested by Canada, the Panel assessed the nature and the character of the risk posed by chrysotile-cement products. The Panel found, on the basis of the scientific evidence, that "no minimum threshold of level of exposure or duration of exposure has been identified with regard to the risk of pathologies associated with chrysotile, except for asbestosis."<sup>157</sup> The pathologies which the Panel identified as being associated with chrysotile are of a very serious nature, namely lung cancer and mesothelioma, which is also a form of cancer.<sup>158</sup> Therefore, we do not agree with Canada that the Panel merely relied on the French authorities' "hypotheses" of the risk.

168. As to Canada's third argument, relating to the level of protection, we note that it is undisputed that WTO Members have the right to determine the level of protection of health that they consider appropriate in a given situation. France has determined, and the Panel accepted<sup>159</sup>, that the chosen level of health protection by France is a "halt" to the spread of *asbestos*-related health risks. By prohibiting all forms of amphibole asbestos, and by severely restricting the use of chrysotile asbestos, the measure at issue is clearly designed and apt to achieve that level of health protection. Our conclusion is not altered by the fact that PCG fibres might pose a risk to health. The scientific evidence before the Panel indicated that the risk posed by the PCG fibres is, in any case, *less* than the risk posed by chrysotile asbestos fibres<sup>160</sup>, although that evidence did *not* indicate that the risk posed by PCG fibres is non-existent. Accordingly, it seems to us perfectly legitimate for a Member to seek to halt the spread of a highly risky product while allowing the use of a less risky product in its place. In short, we do not agree with Canada's third argument.

169. In its fourth argument, Canada asserts that the Panel erred in finding that "controlled use" is not a reasonably available alternative to the Decree. This last argument is based on Canada's assertion that, in *United States – Gasoline*, both we and the panel held that an alternative measure "can only be ruled out if it is shown to be impossible to implement."<sup>161</sup> We understand Canada to mean by this that an alternative measure is only excluded as a "reasonably available" alternative if implementation

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<sup>156</sup>Appellate Body Report, *European Communities – Hormones, supra*, footnote 48, para. 186.

<sup>157</sup>Panel Report, para. 8.202.

<sup>158</sup>*Ibid.*, para. 8.188. See Panel Report, para. 5.29, for a description of mesothelioma given by Dr. Henderson.

<sup>159</sup>*Ibid.*, para. 8.204.

<sup>160</sup>*Ibid.*, para. 8.220.

<sup>161</sup>Canada's appellant's submission, para. 202, referring to, *inter alia*, para. 130 of that submission.

of that measure is "impossible". We certainly agree with Canada that an alternative measure which is impossible to implement is not "reasonably available". But we do not agree with Canada's reading of either the panel report or our report in *United States – Gasoline*. In *United States – Gasoline*, the panel held, in essence, that an alternative measure did not *cease* to be "reasonably" available simply because the alternative measure involved *administrative difficulties* for a Member.<sup>162</sup> The panel's findings on this point were not appealed, and, thus, we did not address this issue in that case.

170. Looking at this issue now, we believe that, in determining whether a suggested alternative measure is "reasonably available", several factors must be taken into account, besides the difficulty of implementation. In *Thailand – Restrictions on Importation of and Internal Taxes on Cigarettes*, the panel made the following observations on the applicable standard for evaluating whether a measure is "necessary" under Article XX(b):

The import restrictions imposed by Thailand could be considered to be "necessary" in terms of Article XX(b) only if there were no alternative measure consistent with the General Agreement, or less inconsistent with it, which Thailand could *reasonably be expected to employ to achieve its health policy objectives*.<sup>163</sup> (emphasis added)

171. In our Report in *Korea – Beef*, we addressed the issue of "necessity" under Article XX(d) of the GATT 1994.<sup>164</sup> In that appeal, we found that the panel was correct in following the standard set forth by the panel in *United States – Section 337 of the Tariff Act of 1930*:

It was clear to the Panel that a contracting party cannot justify a measure inconsistent with another GATT provision as "necessary" in terms of Article XX(d) if an alternative measure which it could reasonably be expected to employ and which is not inconsistent with other GATT provisions is available to it. By the same token, in cases where a measure consistent with other GATT provisions is not reasonably available, a contracting party is bound to use, among the measures reasonably available to it, that which entails the least degree of inconsistency with other GATT provisions.<sup>165</sup>

172. We indicated in *Korea – Beef* that one aspect of the "weighing and balancing process ... comprehended in the determination of whether a WTO-consistent alternative measure" is reasonably available is the extent to which the alternative measure "contributes to the realization of the end

pursued".<sup>166</sup> In addition, we observed, in that case, that "[t]he more vital or important [the] common interests or values" pursued, the easier it would be to accept as "necessary" measures designed to achieve those ends.<sup>167</sup> In this case, the objective pursued by the measure is the preservation of human life and health through the elimination, or reduction, of the well-known, and life-threatening, health risks posed by asbestos fibres. The value pursued is both vital and important in the highest degree. The remaining question, then, is whether there is an alternative measure that would achieve the same end and that is less restrictive of trade than a prohibition.

173. Canada asserts that "controlled use" represents a "reasonably available" measure that would serve the same end. The issue is, thus, whether France could reasonably be expected to employ "controlled use" practices to achieve its chosen level of health protection – a halt in the spread of asbestos-related health risks.

174. In our view, France could not reasonably be expected to employ *any* alternative measure if that measure would involve a continuation of the very risk that the Decree seeks to "halt". Such an alternative measure would, in effect, prevent France from achieving its chosen level of health protection. On the basis of the scientific evidence before it, the Panel found that, in general, the efficacy of "controlled use" remains to be demonstrated.<sup>168</sup> Moreover, even in cases where "controlled use" practices are applied "with greater certainty", the scientific evidence suggests that the level of exposure can, in some circumstances, still be high enough for there to be a "significant residual risk of developing asbestos-related diseases."<sup>169</sup> The Panel found too that the efficacy of "controlled use" is particularly doubtful for the building industry and for DIY enthusiasts, which are the most important users of cement-based products containing chrysotile asbestos.<sup>170</sup> Given these factual findings by the Panel, we believe that "controlled use" would not allow France to achieve its chosen level of health protection by halting the spread of asbestos-related health risks. "Controlled use" would, thus, not be an alternative measure that would achieve the end sought by France.

175. For these reasons, we uphold the Panel's finding, in paragraph 8.222 of the Panel Report, that the European Communities has demonstrated a *prima facie* case that there was no "reasonably available alternative" to the prohibition inherent in the Decree. As a result, we also uphold the Panel's conclusion, in paragraph 8.223 of the Panel Report, that the Decree is "necessary to protect human ... life or health" within the meaning of Article XX(b) of the GATT 1994.

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<sup>166</sup> Appellate Body Report, *Korea – Beef*, *supra*, footnote 49, paras. 166 and 163.

<sup>167</sup> *Ibid.*, para. 162.

<sup>168</sup> Panel Report, para. 8.209.

<sup>169</sup> *Ibid.*, paras. 8.209 and 8.211.

<sup>170</sup> *Ibid.*, paras. 8.213 and 8.214.

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<sup>162</sup> See Panel Report, *United States – Gasoline*, *supra*, footnote 15, paras. 6.26 and 6.28.

<sup>163</sup> Adopted 20 February 1990, BISD 37S/200, para. 75.

<sup>164</sup> *Supra*, footnote 49, paras. 159 ff.

<sup>165</sup> Adopted 7 November 1989, BISD 36S/345, para. 5.26; we expressly affirmed this standard in our Report in *Korea – Beef*, *supra*, footnote 49, para. 166.

C. Article 11 of the DSU

176. As part of its argument that the Panel erred in finding that the measure is justified under Article XX(b) of the GATT 1994, Canada also asserts that the Panel failed to make an objective assessment of the matter, as required by Article 11 of the DSU. According to Canada, the requirement imposed on panels by Article 11 to make an objective assessment of the matter implies "that scientific data must be assessed in accordance with the principle of the balance of probabilities."<sup>171</sup> In particular, Canada asserts that, where the evidence is divergent or contradictory, the "principle of the preponderance of evidence" implies that a panel must take a position as to the respective weight of the evidence.<sup>172</sup> Canada also contends that the Panel failed to assess the facts objectively because the Panel accepted "the opinions of experts on the controlled use of chrysotile, when those experts had no controlled-use expertise."<sup>173</sup>

177. These arguments by Canada on the "balance of probabilities" and the "preponderance of evidence" concern the credibility and weight that the Panel ascribed to different elements of evidence.<sup>174</sup> In essence, Canada argues that the Panel has not taken sufficient account of certain evidence and that the Panel has placed too much weight on certain other evidence. Thus, Canada is challenging the Panel's exercise of discretion in assessing and weighing the evidence. As we have already noted, "[w]e cannot second-guess the Panel in appreciating either the evidentiary value of ... studies or the consequences, if any, of alleged defects in [the evidence]".<sup>175</sup> And, as we have already said, in this case, the Panel's appreciation of the evidence remained well within the bounds of its discretion as the trier of facts.

178. In addition, in the context of the *SPS Agreement*, we have said previously, in *European Communities – Hormones*, that "responsible and representative governments may act in good faith on the basis of what, at a given time, may be a *divergent* opinion coming from qualified and respected sources."<sup>176</sup> (emphasis added) In justifying a measure under Article XX(b) of the GATT 1994, a Member may also rely, in good faith, on scientific sources which, at that time, may represent a divergent, but qualified and respected, opinion. A Member is not obliged, in setting health policy, automatically to follow what, at a given time, may constitute a majority scientific opinion. Therefore,

a panel need not, necessarily, reach a decision under Article XX(b) of the GATT 1994 on the basis of the "preponderant" weight of the evidence.

179. With regard to Canada's argument that certain of the experts lacked expertise in "controlled use", we note that, from the beginning of the process for the selection of experts, the Panel made clear that it wished to consult experts on the "effectiveness of the controlled use of chrysotile."<sup>177</sup> The selection of the experts was the subject of a rigorous procedure which involved the consultation of five institutions with experience in this field and also of the parties.<sup>178</sup> At no stage did Canada object to the selection of any of the experts, nor indicate that any of them was unqualified to deal with issues relating to "controlled use".<sup>179</sup> We also note that the experts were instructed by the Panel to answer only those questions that fell within their area of expertise.<sup>180</sup> As Canada indicates, several experts indicated that particular questions, or parts of questions, posed to them went beyond their area of expertise.<sup>181</sup>

180. In these circumstances, we have serious difficulty accepting that the Panel failed to make an objective assessment by relying on experts who had no expertise. The Panel was entitled to assume that the experts possessed the necessary expertise to answer the questions, or parts of questions, they chose to answer. In other words, it was not incumbent on the Panel expressly to confirm, with respect to every opinion expressed by each expert, that the expert possessed the necessary expertise to give that particular opinion. If Canada thought that one of the experts did not possess the expertise necessary to answer certain questions posed to him, Canada should have raised those concerns, either with the expert, at the meeting the Panel held with the parties and the experts on 17 January 2000, or with the Panel at some other time. We observe, finally, that, where an expert declined to answer a specific question, or part of a question, because of a professed lack of expertise, the Panel had no opinion from that expert on which to rely.

181. For these reasons, we decline Canada's appeal on Article 11 of the DSU.

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<sup>171</sup>Canada's appellant's submission, para. 204.

<sup>172</sup>*Ibid.*

<sup>173</sup>*Ibid.*, para. 209.

<sup>174</sup>*Ibid.*, para. 204.

<sup>175</sup>Appellate Body Report, *Korea – Alcoholic Beverages*, *supra*, footnote 58, para. 161. See, *supra*, para. 160.

<sup>176</sup>*Supra*, footnote 48, para. 194.

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<sup>177</sup>Panel Report, para. 5.1.

<sup>178</sup>*Ibid.*, para. 5.20.

<sup>179</sup>*Ibid.*

<sup>180</sup>*Ibid.*, para. 5.22.

<sup>181</sup>Canada's appellant's submission, para. 211, footnote 219, referring to Panel Report, paras. 5.335, 5.345, 5.346, 5.353, 5.363, 5.370, 5.371, and 5.374, and to Annex VI of the Panel Report, para. 222.

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

182. Before the Panel, Canada claimed, under Article XXIII:1(b) of the GATT 1994, that the application of the measure at issue nullified or impaired benefits accruing to Canada. The European Communities raised preliminary objections, arguing on two grounds that the measure falls outside the scope of application of Article XXIII:1(b). First, the European Communities contended that Article XXIII:1(b) only applies to measures which *do not otherwise fall* under other provisions of the GATT 1994.<sup>182</sup> Second, the European Communities argued that, while it may be possible to have "legitimate expectations" in connection with a purely "commercial" measure, it is not possible to claim "legitimate expectations" with respect to a measure taken to protect human life or health, which can be justified under Article XX(b) of the GATT 1994. Such measures are, the European Communities asserted, excluded from the scope of Article XXIII:1(b).<sup>183</sup>

183. Before examining the substance of Canada's claim under Article XXIII:1(b) of the GATT 1994, the Panel first considered, and rejected, both of these preliminary objections raised by the European Communities, and found, as a consequence, that Canada could invoke Article XXIII:1(b) in respect of the measure.<sup>184</sup> The European Communities appeals the Panel's findings and conclusions relating to the two preliminary objections.

184. Before considering this aspect of the appeal, we note that the Panel went on to examine the substance of Canada's claim under Article XXIII:1(b) and concluded that Canada had not established "the existence of nullification or impairment of a benefit within the meaning of Article XXIII:1(b) of the GATT 1994 as a result of the application of the measure".<sup>185</sup> We note also that this ultimate conclusion by the Panel has not been appealed by either party. Accordingly, we address only the two narrow issues that have been appealed by the European Communities, and we will not address any other aspects of the Panel's findings under Article XXIII:1(b) of the GATT 1994.

185. This appeal is our first occasion to examine Article XXIII:1(b) of the GATT 1994. For this reason, before turning to the appeal by the European Communities, it seems to us useful to make certain preliminary observations about the relationship between Articles XXIII:1(a) and XXIII:1(b) of the GATT 1994. Article XXIII:1(a) sets forth a cause of action for a claim that a Member has failed to carry out one or more of its obligations under the GATT 1994. A claim under Article XXIII:1(a), therefore, lies when a Member is alleged to have acted inconsistently with a provision of the

GATT 1994. Article XXIII:1(b) sets forth a separate cause of action for a claim that, through the application of a measure, a Member has "nullified or impaired" "benefits" accruing to another Member, "whether or not that measure conflicts with the provisions" of the GATT 1994. Thus, it is not necessary, under Article XXIII:1(b), to establish that the measure involved is inconsistent with, or violates, a provision of the GATT 1994. Cases under Article XXIII:1(b) are, for this reason, sometimes described as "non-violation" cases; we note, though, that the word "non-violation" does not appear in this provision. The purpose of this rather unusual remedy was described by the panel in *European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins* ("EEC – Oilseeds") in the following terms:

The idea underlying [the provisions of Article XXIII:1(b)] is that *the improved competitive opportunities that can legitimately be expected from a tariff concession can be frustrated not only by measures proscribed by the General Agreement but also by measures consistent with that Agreement. In order to encourage contracting parties to make tariff concessions they must therefore be given a right of redress when a reciprocal concession is impaired by another contracting party as a result of the application of any measure, whether or not it conflicts with the General Agreement.*<sup>186</sup> (emphasis added)

186. Like the panel in *Japan – Measures Affecting Consumer Photographic Film and Paper* ("*Japan – Film*"), we consider that the remedy in Article XXIII:1(b) "should be approached with caution and should remain an exceptional remedy".<sup>187</sup> That panel stated:

<sup>182</sup> Panel Report, para. 8.255.

<sup>183</sup> *Ibid.*, para. 8.257.

<sup>184</sup> *Ibid.*, paras. 8.265 and 8.274.

<sup>185</sup> *Ibid.*, para. 8.304.

<sup>186</sup> Adopted 25 January 1990, BISD 37S/86, para. 144.

<sup>187</sup> Adopted 22 April 1998, WT/DS44/R, para. 10.37.

Although the non-violation remedy is an important and accepted tool of WTO/GATT dispute settlement and has been "on the books" for almost 50 years, we note that there have only been eight cases in which panels or working parties have substantively considered Article XXIII:1(b) claims. This suggests that both the GATT contracting parties and WTO Members have approached this remedy with caution and, indeed, have treated it as an exceptional instrument of dispute settlement. We note in this regard that both the European Communities and the United States in the *EEC – Oilseeds* case, and the two parties in this case, have confirmed that the *non-violation nullification or impairment remedy should be approached with caution and treated as an exceptional concept*. The reason for this caution is straightforward. *Members negotiate the rules that they agree to follow and only exceptionally would expect to be challenged for actions not in contravention of those rules.*<sup>188</sup> (emphasis added)

187. Against this background, we turn now to the European Communities' argument that Article XXIII:1(b) does not apply to measures that fall within the scope of application of other provisions of the GATT 1994. The text of Article XXIII:1(b) stipulates that a claim under that provision arises when a "benefit" is being "nullified or impaired" through the "application ... of any measure, whether or not it conflicts with the provisions of this Agreement". (emphasis added) The wording of the provision, therefore, clearly states that a claim may succeed, under Article XXIII:1(b), *even if the measure "conflicts" with some substantive provisions of the GATT 1994*. It follows that a measure may, *at one and the same time*, be inconsistent with, or in breach of, a provision of the GATT 1994 *and*, nonetheless, give rise to a cause of action under Article XXIII:1(b). Of course, if a measure "conflicts" with a provision of the GATT 1994, that measure must actually fall within the

<sup>188</sup> *Supra*, footnote 187, para. 10.36. Claims under Article XXIII:1(b) have been considered in the following reports: Working Party Report, *Australia – Ammonium Sulphate*, *supra*, footnote 58; Panel Report, *Germany – Sardines*, *supra*, footnote 58; Panel Report, *Uruguayan Recourse to Article XXIII*, adopted 16 November 1962, BISD 11S/95; Panel Report, *Spain – Soyabean*, *supra*, footnote 58; Panel Report, *European Community – Tariff Treatment on Imports of Citrus Products from Certain Countries in the Mediterranean Region ("EC – Citrus Products")*, L/5776, 7 February 1985, unadopted; Panel Report, *European Economic Community – Production Aids Granted on Canned Peaches, Canned Pears, Canned Fruit Cocktail and Dried Grapes ("EEC – Canned Fruit")*, L/5778, 20 February 1985, unadopted; Panel Report, *Japan – Trade in Semi-Conductors*, adopted 4 May 1988, BISD 35S/116; Panel Report, *United States – Trade Measures Affecting Nicaragua*, L/6053, 13 October 1986, unadopted; Panel Report, *EEC – Oilseeds*, *supra*, footnote 186; Panel Report, *United States – Restrictions on the Importation of Sugar and Sugar-Containing Products Applied under the 1955 Waiver and under the Headnote to the Schedule of Tariff Concessions*, adopted 7 November 1990, BISD 37S/228; Panel Report, *Japan – Film*, *supra*, footnote 187; Panel Report, *Korea – Measures Affecting Government Procurement*, WT/DS1163/R, adopted 19 June 2000. We note that claims under Article XXIII:1(b) of the GATT 1947 were also examined in the Panel Report, *European Economic Community – Follow-up on the Panel Report, Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins ("EEC – Oilseeds II")*, 31 March 1992, BISD 39S/91, unadopted.

Including *EEC – Oilseeds II*, and the present dispute, there have, therefore, been 14 cases in which a claim under Article XXIII:1(b) has been considered by working parties, panels, and, now, the Appellate Body. In six of these cases, the claim under Article XXIII:1(b) was successful and, on three of these occasions, the report was adopted. The successful claims were made in: *Australia – Ammonium Sulphate* (adopted 3 April 1950), *Germany – Sardines* (adopted 31 October 1952), *EC – Citrus Products* (unadopted), *EEC – Canned Fruit* (unadopted), *EEC – Oilseeds* (adopted 25 January 1990) and *EEC – Oilseeds II* (unadopted).

scope of application of that provision of the GATT 1994. We agree with the Panel that this reading of Article XXIII:1(b) is consistent with the panel reports in *Japan – Film* and *EEC – Oilseeds*, which both support the view that Article XXIII:1(b) applies to measures which simultaneously fall within the scope of application of other provisions of the GATT 1994.<sup>189</sup> Accordingly, we decline the European Communities' first ground of appeal under Article XXIII:1(b) of the GATT 1994.

188. The European Communities also contends that the Panel erred in finding that Article XXIII:1(b) applies to measures which pursue health, rather than commercial, objectives and which can, therefore, be justified under Article XX(b) of the GATT 1994. Once again, we look to the text of Article XXIII:1(b), which provides that "the application by another Member of *any measure*" may give rise to a cause of action under that provision. The use of the word "any" suggests that measures of all types may give rise to such a cause of action. The text does not distinguish between, or exclude, certain types of measure. Clearly, therefore, the text of Article XXIII:1(b) contradicts the European Communities' argument that certain types of measure, namely, those with health objectives, are excluded from the scope of application of Article XXIII:1(b).

189. In any event, an attempt to draw the distinction suggested by the European Communities between so-called health and commercial measures would be very difficult in practice. By definition, measures which affect trade in goods, and which are subject to the disciplines of the GATT 1994, have a commercial impact. At the same time, the health objectives of many measures may be attainable only by means of commercial regulation. Thus, in practice, clear distinctions between health and commercial measures may be very difficult to establish. Nor do we see merit in the argument that, previously, only "commercial" measures have been the subject of Article XXIII:1(b) claims, as that does not establish that a claim *cannot* be made under Article XXIII:1(b) regarding a "non-commercial" measure.

190. An important aspect of the European Communities' argument is that a Member cannot have reasonable expectations of continued market access for products which are shown to pose a serious risk to human life or health. However, the paragraphs of the Panel Report appealed by the European Communities involve *exclusively* the Panel's findings on the threshold issues of the scope of application of Article XXIII:1(b). This particular argument of the European Communities, important as it is, simply does not relate to those threshold issues. Rather, the European Communities' argument relates to the substance of a claim that has been determined to fall within the scope of application of Article XXIII:1(b) and, in particular, concerns the issue whether a "benefit" has been "nullified or impaired" by a measure restricting market access for products posing a health risk. Here, we

<sup>189</sup> See Panel Report, para. 8.263, which refers to the Panel Report in *Japan – Film*, *supra*, footnote 187, para. 10.50, and footnote 1214; and *EEC – Oilseeds*, *supra*, footnote 186, para. 144.

emphasize that the European Communities does *not* appeal the Panel's findings relating to the "nullification or impairment" of a "benefit" through the frustration of reasonable expectations by application of the measure at issue. We do not, therefore, find it necessary to examine the European Communities' argument relating to reasonable expectations.

191. For these reasons, we dismiss the European Communities' appeal under Article XXIII:1(b) of the GATT 1994 and uphold the Panel's finding that Article XXIII:1(b) applies to measures which fall within the scope of application of other provisions of the GATT 1994 and which pursue health objectives.

#### **IX. Findings and Conclusions**

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

- (a) reverses the Panel's finding, in paragraph 8.72(a) of the Panel Report, that the *TBT Agreement* "does not apply to the part of the Decree relating to the ban on imports of asbestos and asbestos-containing products because that part does not constitute a 'technical regulation' within the meaning of Annex 1.1 to the TBT Agreement", and finds that the measure, viewed as an integrated whole, does constitute a "technical regulation" under the *TBT Agreement*;
- (b) reverses the Panel's findings, in paragraphs 8.132 and 8.149 of the Panel Report, that "it is not appropriate" to take into consideration the health risks associated with chrysotile asbestos fibres in examining the "likeness", under Article III:4 of the GATT 1994, of those fibres and PCG fibres, and, also, in examining the "likeness", under that provision, of cement-based products containing chrysotile asbestos fibres or PCG fibres;
- (c) reverses the Panel's finding, in paragraph 8.144 of the Panel Report, that chrysotile asbestos fibres and PCG fibres are "like products" under Article III:4 of the GATT 1994; and finds that Canada has not satisfied its burden of proving that these fibres are "like products" under that provision;
- (d) reverses the Panel's finding, in paragraph 8.150 of the Panel Report, that cement-based products containing chrysotile asbestos fibres and cement-based products containing PCG fibres are "like products" under Article III:4 of the GATT 1994; and finds that Canada has not satisfied its burden of proving that these cement-based products are "like products" under Article III:4 of the GATT 1994;

(e) reverses, in consequence, the Panel's finding, in paragraph 8.158 of the Panel Report, that the measure is inconsistent with Article III:4 of the GATT 1994;

(f) upholds the Panel's finding, in paragraphs 8.194, 8.222 and 8.223 of the Panel Report, that the measure at issue is "necessary to protect human ... life or health", within the meaning of Article XX(b) of the GATT 1994; and, finds that the Panel acted consistently with Article 11 of the DSU in reaching this conclusion;

(g) upholds the Panel's finding, in paragraphs 8.265 and 8.274 of the Panel Report, that the measure may give rise to a cause of action under Article XXIII:1(b) of the GATT 1994.

193. It follows from our findings that Canada has not succeeded in establishing that the measure at issue is inconsistent with the obligations of the European Communities under the covered agreements and, accordingly, we do not make any recommendations to the DSB under Article 19.1 of the DSU.

Signed in the original at Geneva this 16th day of February 2001 by:

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Florentino P. Feliciano  
Presiding Member

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James Bacchus  
Member

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Claus-Dieter Ehlermann  
Member

**World Trade Organization**

**European Communities – Conditions for the Granting of  
Tariff Preferences to Developing Countries**

**Report of the Appellate Body, 7 April 2004**

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**EUROPEAN COMMUNITIES – CONDITIONS FOR THE GRANTING  
OF TARIFF PREFERENCES TO DEVELOPING COUNTRIES**

**AB-2004-1**

*Report of the Appellate Body*

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Short Title	Full Case Title and Citation
<i>Argentina – Footwear (EC)</i>	Appellate Body Report, <i>Argentina – Safeguard Measures on Imports of Footwear</i> , WT/DS121/AB/R, adopted 12 January 2000, DSR 2000:1, 515
<i>Brazil – Aircraft</i>	Appellate Body Report, <i>Brazil – Export Financing Programme for Aircraft</i> , WT/DS46/AB/R, adopted 20 August 1999, DSR 1999:III, 1161
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<i>Canada – Autos</i>	Appellate Body Report, <i>Canada – Certain Measures Affecting the Automotive Industry</i> , WT/DS139/AB/R, WT/DS142/AB/R, adopted 19 June 2000, DSR 2000:VI, 2995
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<i>Canada – Ice Cream and Yoghurt</i>	GATT Panel Report, <i>Canada – Import Restrictions on Ice Cream and Yoghurt</i> , L/6568, adopted 5 December 1989, BISD 36S/68
<i>Chile – Price Band System</i>	Appellate Body Report, <i>Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products</i> , WT/DS207/AB/R, adopted 23 October 2002
<i>EC – Bananas III</i>	Appellate Body Report, <i>European Communities – Regime for the Importation, Sale and Distribution of Bananas</i> , WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591
<i>EC – Hormones</i>	Appellate Body Report, <i>EC Measures Concerning Meat and Meat Products (Hormones)</i> , WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:1, 135
<i>EC – Sardines</i>	Appellate Body Report, <i>European Communities – Trade Description of Sardines</i> , WT/DS231/AB/R, adopted 23 October 2002
<i>EC – Tariff Preferences</i>	Panel Report, <i>European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries</i> , WT/DS246/R, circulated to Members 1 December 2003
<i>EEC – Dessert Apples</i>	GATT Panel Report, <i>European Economic Community – Restrictions on Imports of Dessert Apples – Complaint by Chile</i> , L/6491, adopted 22 June 1989, BISD 36S/93
<i>Guatemala – Cement I</i>	Appellate Body Report, <i>Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico</i> , WT/DS60/AB/R, adopted 25 November 1998, DSR 1998:IX, 3767
<i>India – Quantitative Restrictions</i>	Appellate Body Report, <i>India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products</i> , WT/DS90/AB/R, adopted 22 September 1999, DSR 1999:IV, 1763
<i>Japan – Agricultural Products I</i>	GATT Panel Report, <i>Japan – Restrictions on Imports of Certain Agricultural Products</i> , L/6253, adopted 2 March 1988, BISD 35S/163
<i>Korea – Dairy</i>	Appellate Body Report, <i>Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products</i> , WT/DS98/AB/R, adopted 12 January 2000, DSR 2000:1, 3
<i>US – Carbon Steel</i>	Appellate Body Report, <i>United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany</i> , WT/DS213/AB/R and Corr.1, adopted 19 December 2002

Short Title	Full Case Title and Citation
<i>US – Certain EC Products</i>	Appellate Body Report, <i>United States – Import Measures on Certain Products from the European Communities</i> , WT/DS165/AB/R, adopted 10 January 2001, DSR 2001:1, 373
<i>US – Customs User Fee</i>	GATT Panel Report, <i>United States – Customs User Fee</i> , L/6264, adopted 2 February 1988, BISD 35S/245
<i>US – FSC</i>	Appellate Body Report, <i>United States – Tax Treatment for "Foreign Sales Corporations"</i> , WT/DS108/AB/R, adopted 20 March 2000, DSR 2000:III, 1619
<i>US – FSC (Article 21.5 – EC)</i>	Appellate Body Report, <i>United States – Tax Treatment for "Foreign Sales Corporations"</i> , Recourse to Article 21.5 of the DSU by the European Communities, WT/DS108/AB/RW, adopted 29 January 2002
<i>US – Gasoline</i>	Appellate Body Report, <i>United States – Standards for Reformulated and Conventional Gasoline</i> , WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:1, 3
<i>US – Gasoline</i>	Panel Report, <i>United States – Standards for Reformulated and Conventional Gasoline</i> , WT/DS2/R, adopted 20 May 1996, as modified by the Appellate Body Report, WT/DS2/AB/R, DSR 1996:1, 29
<i>US – Malt Beverages</i>	GATT Panel Report, <i>United States – Measures Affecting Alcoholic and Malt Beverages</i> , DS23/R, adopted 19 June 1992, BISD 39S/206
<i>US – MFN Footwear</i>	GATT Panel Report, <i>United States – Denial of Most-Favoured-Nation Treatment as to Non-Rubber Footwear from Brazil</i> , DS18/R, adopted 19 June 1992, BISD 39S/128
<i>US – Section 337</i>	GATT Panel Report, <i>United States Section 337 of the Tariff Act of 1930</i> , L/6439, adopted 7 November 1989, BISD 36S/345
<i>US – Section 211 Appropriations Act</i>	Appellate Body Report, <i>United States – Section 211 Omnibus Appropriations Act of 1998</i> , WT/DS176/AB/R, adopted 1 February 2002
<i>US – Shrimp</i>	Appellate Body Report, <i>United States – Import Prohibition of Certain Shrimp and Shrimp Products</i> , WT/DS58/AB/R, adopted 6 November 1998, DSR 1998:VII, 2755
<i>US – Wool Shirts and Blouses</i>	Appellate Body Report, <i>United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India</i> , WT/DS33/AB/R and Corr.1, adopted 23 May 1997, DSR 1997:1, 323
<i>US – Wool Shirts and Blouses</i>	Panel Report, <i>United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India</i> , WT/DS33/R, adopted 23 May 1997, as upheld by the Appellate Body Report, WT/DS33/AB/R, DSR 1997:1, 343

WORLD TRADE ORGANIZATION  
APPELLATE BODY

TABLE OF ABBREVIATIONS USED IN THIS REPORT

Abbreviation	Description
1971 Waiver Decision	Waiver Decision on the Generalized System of Preferences, GATT Document L/3545, 25 June 1971, BISD 18S/24 (attached as Annex D-2 to the Panel Report)
1999 LDC Waiver	Waiver Decision on Preferential Tariff Treatment for Least-Developed Countries, WT/L/304, 15 June 1999
Agreed Conclusions	Agreed Conclusions of the UNCTAD Special Committee on Preferences (attached as Annex D-4 to the Panel Report)
Charter of Algiers	Charter of Algiers, TD/38, adopted at the Ministerial Meeting of the Group of 77 on 24 October 1967
Drug Arrangements	Special arrangements to combat drug production and trafficking, contained in the Regulation
DSU	<i>Understanding on Rules and Procedures Governing the Settlement of Disputes</i>
Enabling Clause	Decision on Differential and More Favourable Treatment, Reciprocity, and Fuller Participation of Developing Countries, GATT Document L/4903, 28 November 1979, BISD 26S/203 (attached as Annex 2 to this Report)
GATT 1947	<i>General Agreement on Tariffs and Trade 1947</i>
GATT 1994	<i>General Agreement on Tariffs and Trade 1994</i>
General Arrangements	General arrangements described in Article 7 of the Regulation
General Principle Eight	General Principle Eight contained in the Final Act and Report adopted at the First Session of UNCTAD on 15 June 1964, at p. 20 (Exhibit EC-20 submitted by the European Communities to the Panel)
GSP	Generalized System of Preferences
MFN	Most-favoured-nation
OECD Special Report	Report of the Special Group of the Organization for Economic Co-operation and Development (OECD) on Trade with Developing Countries, TD/56, 29 January 1968
Regulation	Council Regulation (EC) No. 2501/2001 of 10 December 2001 applying a scheme of generalised tariff preferences for the period from 1 January 2002 to 31 December 2004, <i>Official Journal of the European Communities</i> , L Series, No. 346 (31 December 2001), p. 1 (Exhibit India-6 submitted by India to the Panel)
Resolution 21(II)	Resolution 21(II) of the Second Session of UNCTAD, entitled "Expansion and Diversification of Exports of Manufactures and Semi-Manufactures of Developing Countries" (attached as Annex D-3 to the Panel Report)
SCM Agreement	<i>Agreement on Subsidies and Countervailing Measures</i>
SPS Agreement	<i>Agreement on the Application of Sanitary and Phytosanitary Measures</i>
UNCTAD	United Nations Conference on Trade and Development
Vienna Convention	<i>Vienna Convention on the Law of Treaties</i> , done at Vienna, 23 May 1969, 1155 U.N.T.S. 331; 8 International Legal Materials 679
Working Procedures	<i>Working Procedures for Appellate Review</i> , WT/AB/WP/7, 1 May 2003
WTO	World Trade Organization
WTO Agreement	<i>Marrakesh Agreement Establishing the World Trade Organization</i>

**European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries**

AB-2004-1

Present:

Abi-Saab, Presiding Member  
Baptista, Member  
Sacerdoti, Member

European Communities, *Appellant*  
India, *Appellee*

Bolivia, *Third Participant*  
Brazil, *Third Participant*  
Colombia, *Third Participant*  
Costa Rica, *Third Participant*  
Cuba, *Third Participant*  
Ecuador, *Third Participant*  
El Salvador, *Third Participant*  
Guatemala, *Third Participant*  
Honduras, *Third Participant*  
Mauritius, *Third Participant*  
Nicaragua, *Third Participant*  
Pakistan, *Third Participant*  
Panama, *Third Participant*  
Paraguay, *Third Participant*  
Peru, *Third Participant*  
United States, *Third Participant*  
Venezuela, *Third Participant*

**I. Introduction**

1. The European Communities appeals certain issues of law and legal interpretations developed in the Panel Report, *European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries* (the "Panel Report").<sup>1</sup> The Panel was established to consider a complaint by India against the European Communities regarding the conditions under which the European Communities accords tariff preferences to developing countries pursuant to Council Regulation (EC) No. 2501/2001 of 10 December 2001 "applying a scheme of generalised tariff preferences for the period from 1 January 2002 to 31 December 2004" (the "Regulation").<sup>2</sup>

<sup>1</sup>WT/DS246/R, 1 December 2003.

<sup>2</sup>*Official Journal of the European Communities*, L Series, No. 346 (31 December 2001), p. 1 (Exhibit India-6 submitted by India to the Panel).

2. The Regulation provides for five preferential tariff "arrangements"<sup>3</sup>, namely:
- (a) general arrangements described in Article 7 of the Regulation (the "General Arrangements");
  - (b) special incentive arrangements for the protection of labour rights;
  - (c) special incentive arrangements for the protection of the environment;
  - (d) special arrangements for least-developed countries; and
  - (e) special arrangements to combat drug production and trafficking (the "Drug Arrangements").<sup>4</sup>

3. All the countries listed in Annex I to the Regulation are eligible to receive tariff preferences under the General Arrangements<sup>5</sup>, which provide, broadly, for suspension of Common Customs Tariff duties on products listed as "non-sensitive" and for reduction of Common Customs Tariff *ad valorem* duties on products listed as "sensitive".<sup>6</sup> The General Arrangements are described in further detail in paragraphs 2.4 and 2.5 of the Panel Report. The four other arrangements in the Regulation provide tariff preferences *in addition* to those granted under the General Arrangements.<sup>7</sup> However, only some of the country beneficiaries of the General Arrangements are also beneficiaries of the other arrangements. Specifically, preferences under the special incentive arrangements for the protection of labour rights and the special incentive arrangements for the protection of the environment are restricted to those countries that "are determined by the European Communities to comply with certain labour [or] environmental policy standards"<sup>8</sup>, respectively. Preferences under the special arrangements for least-developed countries are restricted to certain specified countries.<sup>9</sup> Finally, preferences under the Drug Arrangements are provided only to 12 predetermined countries, namely Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Pakistan, Panama, Peru, and Venezuela.<sup>10</sup>

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<sup>3</sup>Regulation, Art. 1.2.

<sup>4</sup>*Ibid.*

<sup>5</sup>Panel Report, para. 2.4.

<sup>6</sup>Regulation, Arts. 7.1-7.2.

<sup>7</sup>*Ibid.*, Arts. 8-10. For example, these tariff preferences include further reductions in the duties imposed on certain "sensitive" products.

<sup>8</sup>Panel Report, para. 2.3. See Regulation, Arts. 14 and 21, and Annex I (Columns E and G).

<sup>9</sup>Regulation, Annex I (Column H).

<sup>10</sup>*Ibid.* (Column I); Panel Report, paras. 2.3 and 2.7.

4. India is a beneficiary of the General Arrangements but not of the Drug Arrangements, or of any of the other arrangements established by the Regulation. In its request for the establishment of a panel, India challenged the Drug Arrangements as well as the special incentive arrangements for the protection of labour rights and the environment.<sup>11</sup> However, in a subsequent meeting with the Director-General regarding the composition of the Panel—and later in writing to the European Communities—India indicated its decision to limit its complaint to the Drug Arrangements, while reserving its right to bring additional complaints regarding the two "special incentive arrangements".<sup>12</sup> Accordingly, this dispute concerns only the Drug Arrangements.
5. The Panel summarized the effect of the Drug Arrangements as follows:

The result of the Regulation is that the tariff reductions accorded under the Drug Arrangements to the 12 beneficiary countries are greater than the tariff reductions granted under the General Arrangements to other developing countries. In respect of products that are included in the Drug Arrangements but not in the General Arrangements, the 12 beneficiary countries are granted *duty-free* access to the European Communities' market, while all other developing countries must pay the *full duties applicable under the Common Customs Tariff*. In respect of products that are included in both the Drug Arrangements and the General Arrangements and that are deemed "sensitive" under column G of Annex IV to the Regulation with the exception for products of CN codes 0306 13, 1704 10 91 and 1704 10 99, the 12 beneficiary countries are granted *duty-free* access to the European Communities' market, while all other developing countries are entitled only to *reductions in the duties applicable under the Common Customs Tariff*.<sup>13</sup> (original italics)

6. India requested the Panel to find that "the Drug Arrangements set out in Article 10"<sup>14</sup> of the Regulation are inconsistent with Article I:1 of the *General Agreement on Tariffs and Trade 1994* (the "GATT 1994") and are not justified by the Decision on Differential and More Favourable Treatment, Reciprocity, and Fuller Participation of Developing Countries (the "Enabling Clause").<sup>15</sup> In the Panel Report, circulated to Members of the World Trade Organization (the "WTO") on 1 December 2003, the Panel concluded that:

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<sup>11</sup>Request for the establishment of a panel by India, WT/DS246/4, 9 December 2002, p. 2.

<sup>12</sup>Panel Report, para. 1.5.

<sup>13</sup>*Ibid.*, para. 2.8. See also, *ibid.*, para. 2.7.

<sup>14</sup>*Ibid.*, para. 3.1 (referring to India's first written submission to the Panel, para. 67).

<sup>15</sup>GATT Document L/4903, 28 November 1979, BISD 26S/203 (attached as Annex 2 to this Report).

- (a) India has the burden of demonstrating that the European Communities' Drug Arrangements are inconsistent with Article I:1 of GATT 1994;
- (b) India has demonstrated that the European Communities' Drug Arrangements are inconsistent with Article I:1 of GATT 1994;
- (c) the European Communities has the burden of demonstrating that the Drug Arrangements are justified under paragraph 2(a) of the Enabling Clause; [and]
- (d) the European Communities has failed to demonstrate that the Drug Arrangements are justified under paragraph 2(a) of the Enabling Clause].<sup>16</sup>

The Panel also concluded that the European Communities had "failed to demonstrate that the Drug Arrangements are justified under Article XX(b) of GATT 1994".<sup>17</sup> Finally, the Panel concluded, pursuant to Article 3.8 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), that "because the Drug Arrangements are inconsistent with Article I:1 of GATT 1994 and not justified by Article 2(a) of the Enabling Clause or Article XX(b) of GATT 1994, the European Communities has nullified or impaired benefits accruing to India under GATT 1994."<sup>18</sup>

7. On 8 January 2004, the European Communities notified the Dispute Settlement Body of its intention to appeal certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel, pursuant to paragraph 4 of Article 16 of the DSU, and filed a Notice of Appeal<sup>19</sup> pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "*Working Procedures*").<sup>20</sup> On 19 January 2004, the European Communities filed its appellant's submission.<sup>21</sup> On 30 January 2004, Pakistan notified its intention to appear at the oral hearing as a third participant.<sup>22</sup> On 2 February 2004, India filed its appellee's submission.<sup>23</sup> On the same day, Costa Rica, Panama, Paraguay, and the United States each filed a third participant's submission, and Bolivia, Colombia, Ecuador, Peru, and Venezuela filed a joint third participant's submission as the Andean Community.<sup>24</sup> Also on 2 February 2004, Brazil notified its intention to make a statement at the oral

<sup>16</sup>Panel Report, para. 8.1(a)-(d).

<sup>17</sup>*Ibid.*, para. 8.1(e).

<sup>18</sup>*Ibid.*, para. 8.1(f).

<sup>19</sup>Notification of an appeal by the European Communities, WT/DS246/7, 8 January 2004 (attached as Annex 1 to this Report).

<sup>20</sup>WT/AB/WP/7, 1 May 2003.

<sup>21</sup>Pursuant to Rule 21 of the *Working Procedures*.

<sup>22</sup>Pursuant to Rule 24(2) of the *Working Procedures*.

<sup>23</sup>Pursuant to Rule 22 of the *Working Procedures*.

<sup>24</sup>Pursuant to Rule 24(1) of the *Working Procedures*.

hearing as a third participant, and Mauritius notified its intention to appear at the oral hearing as a third participant.<sup>25</sup> Finally, on 2 February 2004, El Salvador, Guatemala, Honduras, and Nicaragua jointly notified their intention to make a statement at the oral hearing as third participants.<sup>26</sup> On 4 February 2004, Cuba notified its intention to appear at the oral hearing as a third participant.<sup>27</sup> By letter dated 16 February 2004, Pakistan submitted a request to make a statement at the oral hearing.<sup>28</sup> No participant objected to Pakistan's request, which was authorized by the Division hearing the appeal on 18 February 2004.<sup>29</sup>

8. The oral hearing in this appeal was held on 19 February 2004. The participants and third participants presented oral arguments (with the exception of Cuba and Mauritius) and responded to questions posed by the Members of the Division hearing the appeal.

## II. Arguments of the Participants and Third Participants

### A. Claims of Error by the European Communities – Appellant

1. The Relationship Between Article I:1 of the GATT 1994 and the Enabling Clause

9. The European Communities argues that the Panel erred in finding that the Enabling Clause is an "exception" to Article I:1 of the GATT 1994 and in assigning to the European Communities the burden of justifying the Drug Arrangements under the Enabling Clause. Furthermore, the European Communities submits, the Panel erred in finding that Article I:1 applies to measures covered by the Enabling Clause. The European Communities requests the Appellate Body to reverse the Panel's consequent finding that the Drug Arrangements are inconsistent with Article I:1 of the GATT 1994 and, because India made no claim with respect to the Enabling Clause, to refrain from assessing the Drug Arrangements under the Enabling Clause.

10. According to the European Communities, the Panel's main reason for deciding that the Enabling Clause is an exception to Article I:1 was that the Enabling Clause does not provide "positive

<sup>25</sup>Pursuant to Rule 24(2) of the *Working Procedures*.

<sup>26</sup>*Ibid.*

<sup>27</sup>Pursuant to Rule 24(4) of the *Working Procedures*.

<sup>28</sup>*Ibid.*

<sup>29</sup>Pursuant to Rule 27(3)(c) of the *Working Procedures*. The Director of the Appellate Body Secretariat advised Pakistan and the other participants in the appeal of the Division's decision by letter dated 18 February 2004.

rules establishing obligations in themselves".<sup>30</sup> In the European Communities' view, however, the fact that developed countries are not legally obliged to implement schemes pursuant to the Generalized System of Preferences ("GSP") does not mean that the Enabling Clause does not impose positive obligations, or that it is an exception to Article I:1. The European Communities argues that the Panel's reasoning suggests that, if a WTO provision applies only when a WTO Member takes a particular step that it is not obliged to take, that provision cannot create a positive obligation and must be an exception. According to the European Communities, this test is not consistent with Appellate Body decisions and "would lead to manifestly absurd results".<sup>31</sup> For example, the European Communities contends, this test would mean that the following provisions do not impose positive rules establishing obligations in themselves, despite contrary reasoning in previous Appellate Body decisions: Article 27.4 of the *Agreement on Subsidies and Countervailing Measures* (the "SCM Agreement"); Article 3.3 of the *Agreement on the Application of Sanitary and Phytosanitary Measures* (the "SPS Agreement"); Article 2.4 of the *Agreement on Technical Barriers to Trade*; and Article 6 of the *Agreement on Textiles and Clothing*.<sup>32</sup> According to the European Communities, Articles VI and XIX of the GATT 1994 would also be rendered exceptions under the Panel's reasoning, contrary to well-established GATT and WTO panel practice.

11. The European Communities suggests that the Panel should have begun its analysis by examining the ordinary meaning of the word "notwithstanding" in the Enabling Clause. This ordinary meaning, in the view of the European Communities, does not compel the Panel's finding that the Enabling Clause is an "exception" to Article I:1. This is apparent from the dissenting opinion in the Panel Report and the Panel's own recognition that the definition of "notwithstanding" is not dispositive of this question. Therefore, the European Communities argues, in accordance with the basic rules of treaty interpretation in Article 31 of the *Vienna Convention on the Law of Treaties* (the "*Vienna Convention*")<sup>33</sup>, the Panel should have proceeded to examine the relevant "content",<sup>34</sup> context, and object and purpose of the Enabling Clause in order to identify the relationship between

<sup>30</sup>European Communities' appellant's submission, para. 32 (quoting Panel Report, para. 7.35, itself quoting Appellate Body Report, *US – Wool Shirts and Blouses*, p. 16, DSR 1997:1, at 337).

<sup>31</sup>*Ibid.*, para. 34.

<sup>32</sup>*Ibid.*, para. 35 (referring to Appellate Body Report, *Brazil – Aircraft*, paras. 134-141; Appellate Body Report, *EC – Hormones*, paras. 97-104; Appellate Body Report, *EC – Sardines*, para. 275; and Appellate Body Report, *US – Wool Shirts and Blouses*, pp. 12-17, DSR 1997:1, at 333-338).

<sup>33</sup>Done at Vienna, 23 May 1969, 1155 U.N.T.S. 331; 8 International Legal Materials 679.

<sup>34</sup>European Communities' appellant's submission, paras. 18 and 39, and heading 2.5.1.

the Enabling Clause and Article I:1. Instead, the European Communities observes, the Panel simply "assumed"<sup>35</sup> that the Enabling Clause is an exception to Article I:1.

12. Turning to the content and context of the Enabling Clause, the European Communities submits that the Enabling Clause provides a comprehensive set of rules that positively regulate the substantive content of GSP schemes, to the exclusion of the rules in Article I:1 of the GATT 1994. Specifically, the European Communities emphasizes that the words "generalized, non-reciprocal and non discriminatory" in footnote 3 of the Enabling Clause are distinct from and are intended to replace the most-favoured-nation ("MFN") obligation in Article I:1. The European Communities also argues that, according to the Panel's own reasoning, footnote 3 should be interpreted in the context of the Agreed Conclusions of the Special Committee on Preferences of the United Nations Conference on Trade and Development (the "Agreed Conclusions")<sup>36</sup> and the submissions by developed countries to that committee. As such, the detailed obligations created by paragraph 2(a), footnote 3, and paragraph 3(c) of the Enabling Clause go far beyond "mere 'anti-abuse' safeguards".<sup>37</sup> The European Communities contends that the Enabling Clause is unlike the chapeau of Article XX of the GATT 1994, which neither regulates the substantive content of measures adopted by Members, nor replaces the substantive rules from which Article XX derogates.

13. The European Communities relies in support of its argument on the position of the Enabling Clause within the GATT 1994 and the *Marrakesh Agreement Establishing the World Trade Organization* (the "*WTO Agreement*"). Thus, the European Communities contends that if paragraph 2(a) of the Enabling Clause were an exception to Article I:1, it would typically be found in Article I, or immediately after that Article. This is not the case, however. The Enabling Clause is a separate decision complementing Part IV of the GATT 1994, which is entitled "Trade and Development". In the view of the European Communities, Part IV of the GATT 1994 and the Enabling Clause cannot be "mere 'exception[s]'" to the GATT 1994.<sup>38</sup> Rather, the European Communities argues, they constitute a "special regime" for developing countries to address inequalities among the WTO Membership.<sup>39</sup>

14. The European Communities submits that its understanding of the relationship between Article I:1 and the Enabling Clause is supported by the object and purpose of the Enabling Clause, in

<sup>35</sup>European Communities' appellant's submission, para. 31.

<sup>36</sup>Attached as Annex D-4 to the Panel Report.

<sup>37</sup>European Communities' appellant's submission, para. 48.

<sup>38</sup>*Ibid.*, para. 51.

<sup>39</sup>*Ibid.*

accordance with the rules of treaty interpretation. The European Communities emphasizes that the Enabling Clause is "the most concrete, comprehensive and important application"<sup>40</sup> of the principle of special and differential treatment. In the view of the European Communities, special and differential treatment is "the most basic principle of the international law of development"<sup>41</sup>, and it constitutes *lex specialis* that applies to the exclusion of more general WTO rules on the same subject matter. In concluding that the Enabling Clause is an "exception" to Article I:1, the Panel chose to "disregard"<sup>42</sup> this principle. Moreover, the European Communities argues, characterizing special and differential treatment as an "exception" suggests that this principle "is *discriminatory* against the developed country Members".<sup>43</sup> In fact, special and differential treatment is designed to achieve effective equality among Members. Therefore, the European Communities contends that the Panel's reasoning undermines the principle of special and differential treatment and challenges its "legitimacy".<sup>44</sup> The European Communities also asserts that the Panel was "oblivious"<sup>45</sup> to certain elements of the drafting history of the Enabling Clause, which indicate that the Contracting Parties intended to strengthen the legal status of GSP schemes in the GATT by replacing the Waiver Decision on the Generalized System of Preferences (the "1971 Waiver Decision")<sup>46</sup> with the Enabling Clause.

15. The European Communities further contends that special and differential treatment is critical to achieving one of the fundamental objectives of the *WTO Agreement*, as identified in its Preamble: ensuring that developing countries "secure a share in the growth in international trade commensurate with the needs of their economic development".<sup>47</sup> Therefore, according to the European Communities, the object and purpose of the Enabling Clause clearly distinguish it from exceptions such as those found in Article XX(a) and (b) of the GATT 1994, which generally allow Members to adopt "legitimate policy objectives"<sup>48</sup> that are *separate and distinct* from the objectives of the *WTO Agreement*. In the European Communities' view, the Appellate Body decision in *Brazil – Aircraft* confirms that the fact that a provision confers special and differential treatment is highly relevant in determining whether that provision constitutes an exception.

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<sup>40</sup>European Communities' appellant's submission, para. 20.

<sup>41</sup>*Ibid.*, para. 21.

<sup>42</sup>*Ibid.*, para. 23.

<sup>43</sup>*Ibid.*, para. 26. (original italics)

<sup>44</sup>*Ibid.*

<sup>45</sup>*Ibid.*, para. 25.

<sup>46</sup>GATT Document L/3545, 25 June 1971, BISD 18S/24 (attached as Annex D-2 to the Panel Report).

<sup>47</sup>European Communities' appellant's submission, para. 20 (quoting *WTO Agreement*, Preamble, second recital).

<sup>48</sup>*Ibid.*, para. 52.

16. The European Communities notes the Panel's suggestion that absurd results would flow from characterizing the Enabling Clause as excluding the application of Article I:1 because it "would mean that GSP imports from different developing countries could be subject to different taxation levels in the importing country's domestic market."<sup>49</sup> According to the European Communities, the Panel confuses *tariff measures* covered by paragraph 2(a) with the *imported products* to which such measures apply. Finding that the Enabling Clause excludes the application of Article I:1 would mean only that Article I:1 does not apply to a *tariff measure* falling within paragraph 2(a) of the Enabling Clause. It would not mean, as the Panel suggested, that Article I:1 does not apply with respect to *imported products* covered by such a *tariff measure*.

17. The European Communities submits that, as a result of the Panel's erroneous findings that the Enabling Clause is an "exception" to Article I:1 and that the Enabling Clause does not prevent the continued application of Article I:1, the Panel found that the European Communities bears the burden of justifying the Drug Arrangements under the Enabling Clause. According to the European Communities, the Enabling Clause imposes "positive obligations"<sup>50</sup> and is not an exception. As such, it is India that must, in the first instance, claim that the Drug Arrangements are inconsistent with the Enabling Clause and thereby bear the burden of demonstrating that inconsistency. According to the European Communities, India made no claim under the Enabling Clause. Consequently, the European Communities requests the Appellate Body to reverse the Panel's finding that the Drug Arrangements are inconsistent with Article I:1 of the GATT 1994 and to refrain from examining the consistency of the Drug Arrangements with the Enabling Clause.

2. Whether the Drug Arrangements are Justified Under the Enabling Clause

18. The European Communities makes a "subsidiary" appeal, which would arise only if the Appellate Body were to find that the Enabling Clause is an exception to Article I:1 of the GATT 1994, or that India made a valid claim under the Enabling Clause. Specifically, the European Communities claims "subsidiarily"<sup>51</sup> that the Panel erred in finding that the Drug Arrangements are not "justified"<sup>52</sup> under paragraph 2(a) of the Enabling Clause and, therefore, requests the Appellate Body to reverse this finding.

19. According to the European Communities, this finding of the Panel was based on two erroneous legal interpretations. The first alleged error relates to the Panel's interpretation of the term

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<sup>49</sup>European Communities' appellant's submission, para. 56 (quoting Panel Report, para. 7.46).

<sup>50</sup>*Ibid.*, para. 39.

<sup>51</sup>*Ibid.*, para. 67.

<sup>52</sup>*Ibid.* (quoting Panel Report, para. 7.177).

"non-discriminatory" in footnote 3 of the Enabling Clause as requiring GSP schemes to provide "identical" preferences to "all" developing countries without differentiation, except with regard to *a priori* import limitations as permissible safeguard measures. The second error alleged by the European Communities concerns the Panel's interpretation of the term "developing countries" in paragraph 2(a) of the Enabling Clause as meaning *all* developing countries, except with regard to *a priori* limitations.

20. The European Communities asserts that the Panel's interpretation of the word "non-discriminatory" in footnote 3 of the Enabling Clause is erroneous because the phrase "generalized, non-reciprocal and non discriminatory" in footnote 3 merely refers to the description of the GSP in the 1971 Waiver Decision and, of itself, does not impose any legal obligation on preference-granting countries.<sup>53</sup> Even assuming such obligations existed, the European Communities maintains, the Panel failed to take into account the context of footnote 3 and the object and purpose of the Enabling Clause. Properly interpreted, the European Communities argues, the word "non-discriminatory" allows a preference-granting country to accord differential tariff treatment in its GSP scheme to developing countries that have different development needs according to "objective criteria", provided that tariff differentiation is an "adequate" response to these differences.<sup>54</sup>

21. The European Communities emphasizes that the immediate context for interpreting the term "non-discriminatory" in footnote 3 includes the terms "generalized" and "non-reciprocal" in that same footnote. These three terms express "distinct requirement[s]"<sup>55</sup>, according to the European Communities, and they must be interpreted so that each is compatible with the other two, without being rendered redundant.

22. According to the European Communities, the ordinary meaning of the word "generalized" and the negotiating history indicate that GSP schemes are not required to cover *all* developing countries. The word "generalized" in footnote 3 was intended to distinguish these preferences from "special" preferences, which were granted to selected developing countries for political, historical, or geographical reasons. The European Communities maintains that consultations in the United Nations Conference on Trade and Development ("UNCTAD") led to a compromise in the Agreed Conclusions such that developed countries would, "in general"<sup>56</sup>, recognize as beneficiaries those countries that

considered themselves as developing countries, although a developed country might decide to exclude a country *ab initio* on grounds it considered "compelling".<sup>57</sup>

23. In contrast to the term "generalized", the European Communities argues, the word "non-discriminatory" relates to whether developed countries may grant different preferences to individual developing countries that have already been recognized as beneficiaries of a GSP scheme. The European Communities submits that the Panel's interpretation of "non-discriminatory", as requiring that identical preferences be granted to *all* developing countries, would render redundant the term "generalized".

24. Referring to the term "non-reciprocal" in footnote 3, the European Communities argues that reciprocity, in connection with inter-state relations, generally refers to an exchange of identical or similar benefits. In contrast to the word "unconditionally" found in Article I:1 of the GATT 1994, the European Communities argues, the word "non-reciprocal" was not intended to prevent developed countries from attaching all types of conditions to preferences granted under GSP schemes. Rather, in the European Communities' view, the word "non-reciprocal" only prohibits developed countries from imposing conditions of *reciprocity*. The European Communities contends that the Panel's interpretation of "non-discriminatory" precludes the imposition of *any* conditions on the granting of preferences, thereby rendering redundant the word "non-reciprocal" in footnote 3. In addition, the European Communities claims, the Panel's interpretation equates *conditional* preferences with *discriminatory* preferences. In fact, according to the European Communities, a preference is not rendered discriminatory by virtue of a condition being attached to it if the condition applies equally to, and is capable of being fulfilled by, all GSP beneficiaries "that are in the same situation".<sup>58</sup>

25. The European Communities maintains that its interpretation of "non-discriminatory" in footnote 3 does not render redundant paragraph 2(d) of the Enabling Clause, as the Panel suggested. In the view of the European Communities, the scope of paragraph 2(a) differs from that of paragraph 2(d) in three respects. First, paragraph 2(a) applies to preferences granted by *developed* countries, whereas paragraph 2(d) includes preferences granted by *any* WTO Member. Secondly, paragraph 2(a) relates only to preferences under GSP schemes, whereas paragraph 2(d) relates to any measures imposed in favour of developing countries. Thirdly, paragraph 2(a) applies only to tariff measures, whereas paragraph 2(d) applies to any kind of "special treatment".<sup>59</sup> In addressing only the

<sup>53</sup>European Communities' response to questioning at the oral hearing.

<sup>54</sup>European Communities' appellant's submission, para. 4.

<sup>55</sup>*Ibid.*, para. 80.

<sup>56</sup>*Ibid.*, para. 87.

<sup>57</sup>European Communities' appellant's submission, paras. 85 and 87.

<sup>58</sup>*Ibid.*, para. 120.

<sup>59</sup>*Ibid.*, para. 122 (quoting Enabling Clause, para. 2(d) (attached as Annex 2 to this Report)).

last of these differences, the European Communities argues, the Panel's reasoning was "manifestly flawed".<sup>60</sup>

26. The European Communities points out that the Panel found that paragraph 3(c) of the Enabling Clause allows developed countries to differentiate in their GSP schemes in only two ways, namely, in connection with least-developed countries and in the implementation of *a priori* limitations. According to the European Communities, the Panel arrived at this interpretation despite the absence of any such restriction in the text of paragraph 3(c) and despite the Panel's acceptance of the European Communities' argument that the "needs" described in paragraph 3(c) extend to individual or common needs of particular categories of developing countries. In fact, the European Communities argues, paragraph 3(c) lends contextual support to the European Communities' interpretation of the word "non-discriminatory" in footnote 3. The European Communities claims that the objective described in paragraph 3(c) is best achieved by allowing developed countries to design their GSP schemes so as to take into account the development needs of certain categories of developing countries.

27. The European Communities argues that the Panel's contrary interpretation of paragraph 3(c) stems from the Panel's concern that developed countries might abuse their discretion by distinguishing arbitrarily between developing countries. In the view of the European Communities, such policy concerns cannot replace the text of paragraph 3(c). Furthermore, the European Communities submits that this concern is unwarranted because the European Communities' interpretation of "non-discriminatory" would not allow a preference-granting country to distinguish between developing countries on the basis of political, historical, or geographical ties. Rather, a distinction would be allowed only if it: (i) pursued an "objective which is legitimate in the light of the objectives of the Enabling Clause" and the principle of special and differential treatment; and (ii) represented a "reasonable" and "proportionate" means of achieving that objective.<sup>61</sup> In order to assess whether these criteria are met, panels need to analyze the relevant facts.

28. The European Communities contends that, because of the Panel's erroneous legal interpretations, the Panel made insufficient factual findings in order for the Appellate Body to complete the legal analysis regarding the consistency of the Drug Arrangements with footnote 3. Nevertheless, should the Appellate Body decide to complete this analysis, the European Communities requests the Appellate Body to find that the Drug Arrangements are consistent with the term "non-discriminatory" in footnote 3 and, therefore, with paragraph 2(a) of the Enabling Clause.

<sup>60</sup>European Communities' appellant's submission, para. 125.

<sup>61</sup>*Ibid.*, para. 135.

29. The European Communities contends that, although tariff preferences may not be an "adequate" or "appropriate" response to other development problems, drug production and trafficking form major economic activities in the relevant countries, which activities cannot be eliminated without the provision of "alternative licit activities".<sup>62</sup> Therefore, the European Communities claims that tariff preferences are an appropriate response to the drug problem, as recognized by the Members of the WTO—through the Preamble to the *Agreement on Agriculture* and the waiver for the United States' Andean Trade Preference Act<sup>63</sup>—and the United Nations—through other instruments. Furthermore, the European Communities argues that the Drug Arrangements are non-discriminatory because the drug problem affects individual developing countries in different ways, and because beneficiaries under the Drug Arrangements are designated according to the impact of the drug problem in those countries.

30. The European Communities distinguishes the "object and purpose" of the Enabling Clause from that of Article I:1 of the GATT 1994. Article I:1 focuses on providing equal conditions of competition for imports of like products from WTO Members, whereas the Enabling Clause embodies special and differential treatment for developing countries and, therefore, aims to provide unequal competitive opportunities to respond to the needs of such countries. The European Communities claims that, in the light of the objectives associated with special and differential treatment, providing additional preferences to countries with particular development needs is not discriminatory in the context of the Enabling Clause. However, the Panel failed to take into account these objectives. The European Communities contends that the Panel should have interpreted the objectives described in the Preamble to the *WTO Agreement* in a harmonious manner, instead of assuming that the objective of eliminating discrimination prevails over the objective of ensuring that developing countries secure a share of international trade commensurate with their development needs.

31. The European Communities contends that the Panel relied selectively and incorrectly on certain UNCTAD texts to support its findings. According to the European Communities, some of these documents do not assist in interpreting footnote 3 of the Enabling Clause.<sup>64</sup> In several cases, this is because they relate not to the issue of non-discrimination, but to the exclusion of certain

<sup>62</sup>European Communities' appellant's submission, paras. 144-145.

<sup>63</sup>*Ibid.*, para. 148 (referring to Waiver Decision on the United States – Andean Trade Preference Act, GATT Document L/6991, 19 March 1992, BISD 39S/385; renewed 14 October 1996, WT/L/184).

<sup>64</sup>*Ibid.*, paras. 159-160 (referring to Resolution 21(II) of the Second Session of UNCTAD, entitled "Expansion and Diversification of Exports of Manufactures and Semi-Manufactures of Developing Countries" (attached as Annex D-3 to the Panel Report) ("Resolution 21(II)"), and paras. 182-183 (referring to the Recommendation contained in Annex A.II.1 to the Final Act and Report adopted at the First Session of UNCTAD on 15 June 1964, at p. 26).

developing countries *ab initio* from GSP schemes.<sup>65</sup> The European Communities contends that several other documents that the Panel relied on contain merely "expectations"<sup>66</sup> or "aim[s]"<sup>67</sup> of particular parties, rather than agreed statements of "legally binding" obligations.<sup>68</sup> Finally, the European Communities argues, the Agreed Conclusions do not purport to be an exhaustive regulation of GSP schemes. Therefore, in the European Communities' view, the allowance under the Agreed Conclusions for differentiation in favour of least-developed countries does not mean that the Agreed Conclusions prohibit all other forms of differentiation between developing countries.

32. The European Communities submits that the practice by developed countries of seeking waivers in order to provide more favourable treatment to a limited number of developing countries—as highlighted by the Panel—does not mean that such treatment may not otherwise be provided. According to the European Communities, the waivers mentioned by the Panel all relate to the restriction of preferences *ab initio* to particular countries in a particular region. The European Communities further points out that, in seeking these waivers, the preference-granting countries did not claim that the preferences were restricted to developing countries with development needs of a specific kind.

33. The European Communities contends that the Panel's interpretation of the term "developing countries" in paragraph 2(a) of the Enabling Clause is erroneous because it is entirely dependent on the Panel's erroneous interpretation of the word "non-discriminatory". In the European Communities' view, as the word "non-discriminatory" in footnote 3 of the Enabling Clause allows Members to differentiate between developing countries with different development needs, it follows for the same reasons that paragraph 2(a) does not require Members to grant the same preferences to *all* developing countries.

34. For these reasons, the European Communities requests the Appellate Body to reverse the Panel's finding that the Drug Arrangements are inconsistent with paragraph 2(a) of the Enabling Clause and, in particular, with footnote 3 thereof.

<sup>65</sup>European Communities' appellant's submission, paras. 162-163 (referring to the Charter of Algiers, TD/38, adopted at the Ministerial Meeting of the Group of 77 on 24 October 1967 ("Charter of Algiers")) and paras. 179-181 (referring to General Principle Eight contained in the Final Act and Report adopted at the First Session of UNCTAD on 15 June 1964, at p. 20 (Exhibit EC-20 submitted by the European Communities to the Panel) ("General Principle Eight")).

<sup>66</sup>*Ibid.*, para. 162 (referring to Charter of Algiers).

<sup>67</sup>*Ibid.*, para. 165 (referring to the Report of the Special Group of the Organization for Economic Co-operation and Development (OECD) on Trade with Developing Countries, TD/56, 29 January 1968 ("OECD Special Report")).

<sup>68</sup>*Ibid.*, para. 180 (referring to General Principle Eight).

B. *Arguments of India – Appellee*

1. The Relationship Between Article I:1 of the GATT 1994 and the Enabling Clause

35. India argues that the Panel correctly found that the Enabling Clause is an "exception" to Article I:1 of the GATT 1994 and requests the Appellate Body to uphold this finding. In addition, India submits that it made a claim against the Drug Arrangements under the Enabling Clause and that, therefore, the Appellate Body should examine the consistency of the Drug Arrangements under the Enabling Clause, even if it finds that the Enabling Clause is not an exception to Article I:1.

36. India contends that the Panel's test as to what is an "exception" is consistent with previous Appellate Body decisions. According to India, the Appellate Body drew an important distinction in *US – Wool Shirts and Blouses* between "positive rules establishing obligations in themselves" and "exceptions" to those obligations.<sup>69</sup> India states that an exception is an "affirmative defence"<sup>70</sup> and, accordingly, panels examine the consistency of a challenged measure with an exception only if the Member complained against invokes the exception to justify its measure. This leaves the Member with the choice of which exceptions to invoke and prevents exceptions being turned into rules. In other words, in India's view, a Member needs to comply with a provision that is an exception only when the Member invokes that exception to justify an inconsistency with another provision.

37. Applying this reasoning to the present dispute, India characterizes paragraph 2(a) of the Enabling Clause as an "exception" to Article I:1, because it grants developed-country Members a "conditional right"<sup>71</sup> to provide tariff preferences to developing-country Members under the conditions contained in paragraphs 2(a) and 3 of the Enabling Clause. India submits that these paragraphs impose conditions only on Members who invoke the Enabling Clause as a defence, whereas Article I:1 imposes obligations regardless of the defence invoked.

38. India argues, with reference to the *Vienna Convention*, that "subsequent practice"<sup>72</sup> supports its interpretation. First, India maintains that all waivers for preferential tariff treatment for products from developing countries have permitted derogations from Article I without mentioning the Enabling

<sup>69</sup>India's appellee's submission, para. 36 (quoting Appellate Body Report, *US – Wool Shirts and Blouses*, p. 16, DSR 1997:1, at 337).

<sup>70</sup>*Ibid.*, para. 36.

<sup>71</sup>*Ibid.*, para. 39.

<sup>72</sup>*Ibid.*, para. 42 (referring to *Vienna Convention*, Art. 31.3(b)).

Clause. Indeed, according to India, the fact that the European Communities requested a waiver<sup>73</sup> from its obligations *under Article I:1* in respect of the Drug Arrangements cannot be reconciled with the European Communities' position that the Enabling Clause excludes the application of Article I:1. Secondly, India refers to two GATT panels that examined, first, the consistency of a challenged measure under Article I:1, before proceeding to consider whether the measure was authorized under the Enabling Clause. India regards this as evidence of the "common understanding" of the Contracting Parties to the *General Agreement on Tariffs and Trade 1947* (the "GATT 1947") regarding the relationship between Article I:1 and the Enabling Clause.<sup>74</sup>

39. India disputes the European Communities' contention that the Enabling Clause is not an exception to Article I:1 because the Enabling Clause constitutes *lex specialis*. India argues, with reference to a study by the International Law Commission and certain Appellate Body decisions<sup>75</sup>, that the "maxim *lex specialis derogat legi generali*"<sup>76</sup> means not that a special rule necessarily excludes the application of a related general rule, but that the two rules apply cumulatively, and the special rule prevails over the general rule only to the extent of any conflict between the two rules. Thus, India maintains, developing-country Members have not waived their rights under Article I:1, which applies "cumulatively" with the Enabling Clause, except to the extent that these provisions are in conflict with each other.<sup>77</sup>

40. India also contests the European Communities' reliance on the Appellate Body decisions in *Brazil – Aircraft* and *EC – Hormones*. India states that these appeals related to Article 27.2(a) of the *SCM Agreement* and Article 3.1 of the *SPS Agreement*, both of which provisions explicitly exclude other provisions. India argues that, in contrast, the Enabling Clause does not clearly exclude the application of Article I:1 of the GATT 1994. In India's view, this supports India's contention that Article I:1 and the Enabling Clause apply "concurrently".<sup>78</sup>

<sup>73</sup>Council for Trade in Goods, Request for a WTO Waiver, "New EC Special Tariff Arrangements to Combat Drug Production and Trafficking", G/C/W/328, 24 October 2001 (Exhibit India-2(b) submitted by India to the Panel).

<sup>74</sup>India's appellee's submission, para. 43 (referring to GATT Panel Report, *US – Customs User Fee*, 1988, BISD 35S/245, at 289-290; and GATT Panel Report, *US – MFN Footwear*, 1992, BISD 39S/128, at 153).

<sup>75</sup>*Ibid.*, paras. 76-80 (referring to International Law Commission, *Study Group on Fragmentation: Koskenniemi*, p. 5, <[http://www.un.org/law/ilc/sessions/55/fragmentation\\_outline.pdf](http://www.un.org/law/ilc/sessions/55/fragmentation_outline.pdf)>; Appellate Body Report, *Argentina – Footwear (EC)*, para. 89; and Appellate Body Report, *Guatemala – Cement I*, para. 65).

<sup>76</sup>*Ibid.*, para. 76.

<sup>77</sup>*Ibid.*, heading II.C.1.

<sup>78</sup>*Ibid.*, para. 51.

41. India claims that, even if the Appellate Body were to find that the Enabling Clause is not an exception to Article I:1, the Appellate Body should assess the consistency of the Drug Arrangements with the Enabling Clause because India did make a claim under the Enabling Clause. The European Communities' argument to the contrary, according to India, is "factually baseless".<sup>79</sup> India highlights that it originally requested the establishment of a panel "to examine whether [the Drug Arrangements] are consistent with Article I:1 ... and ... the Enabling Clause".<sup>80</sup> In addition, India maintains that, in its first and second written submissions to the Panel, it requested the Panel to find that the Drug Arrangements "are not justified [by] the Enabling Clause".<sup>81</sup> Moreover, India states that the European Communities acknowledged in its first written submission to the Panel that the Enabling Clause forms part of India's claim<sup>82</sup>, and that the Panel confirmed India's inclusion of this claim in paragraph 7.61 of the Panel Report.

42. India submits that it does not follow from India's characterization of the Enabling Clause as an "exception"—which was a "procedural argument" regarding the allocation of the burden of proof—that India made no "substantive" claims under the Enabling Clause.<sup>83</sup> India maintains that, in response to questioning by the Panel, it "merely stated that the Enabling Clause is not a *material element* of India's claim under Article I:1 of the *GATT*."<sup>84</sup> Furthermore, India reiterated its request for the Panel to examine the consistency of the Drug Arrangements with the Enabling Clause at the second substantive meeting of the Panel and at the interim review stage. In addition, India maintains that the Panel would have had "competence"<sup>85</sup> to assess the Drug Arrangements under the Enabling Clause even if the Panel had found that the Enabling Clause is not an exception to Article I:1.<sup>86</sup> In India's view, requiring India to resubmit its claims under the Enabling Clause to a new panel would be contrary to the "fundamental principle of good faith"<sup>87</sup> and the objectives of the dispute settlement

<sup>79</sup>India's appellee's submission, para. 52.

<sup>80</sup>*Ibid.*, para. 54 (quoting request for the establishment of a panel by India, WT/DS246/4, 9 December 2002, p. 2). (italics added by India in its appellee's submission)

<sup>81</sup>*Ibid.*, para. 56 (quoting India's first written submission to the Panel, para. 67; and India's second written submission to the Panel, para. 164). (italics added by India in its appellee's submission)

<sup>82</sup>*Ibid.*, para. 58 (referring to European Communities' first written submission to the Panel, paras. 57, 141, and 206).

<sup>83</sup>*Ibid.*, para. 70.

<sup>84</sup>*Ibid.*, para. 64. (original italics)

<sup>85</sup>*Ibid.*, heading II.B.3.

<sup>86</sup>*Ibid.*, paras. 70-71 (referring to Panel Report, *US – Wool Shirts and Blouses*; Appellate Body Report, *EC – Hormones*, footnote 71 to para. 109 and footnote 180 to para. 197; and DSU, Arts. 7.2 and 11).

<sup>87</sup>*Ibid.*, para. 72 (referring to Appellate Body Report, *US – FSC*, para. 166).

system.<sup>88</sup> India asserts that the question of which party bears the burden of proof "does not affect the outcome of this dispute".<sup>89</sup>

43. Finally, India emphasizes that the European Communities has not yet obtained a waiver from its obligations under Article I:1 with respect to the Drug Arrangements and that only the WTO Members can provide such a waiver.

44. For these reasons, India requests the Appellate Body to uphold the Panel's finding that the Enabling Clause is an exception to Article I:1 of the GATT 1994.

## 2. Whether the Drug Arrangements are Justified Under the Enabling Clause

45. India requests the Appellate Body to uphold the Panel's finding that the Drug Arrangements are not justified under the Enabling Clause. In particular, India maintains that paragraph 2(a) of the Enabling Clause does not authorize the European Communities to differentiate between developing-country Members that are beneficiaries under the European Communities' GSP scheme.

46. At the outset, India submits that the present dispute focuses not on the European Communities' initial selection of particular developing countries as beneficiaries under its GSP scheme, but on the European Communities' treatment of developing countries already identified as beneficiaries under that scheme. Therefore, according to India, the Appellate Body is not required to examine legal issues arising from the initial selection of beneficiaries under the Enabling Clause. Rather, India urges the Appellate Body to find that the term "developing countries" in footnote 3 of the Enabling Clause includes at least those countries that are beneficiaries under a given GSP scheme, and that the words "products originating in developing countries" in paragraph 2(a) refer to products originating in any of those beneficiary countries.

47. India argues that its interpretation is reinforced by the nature of the MFN principle embodied in Article I:1 as "a fundamental norm of the rules-based multilateral trading system of the WTO".<sup>90</sup> India points to Appellate Body decisions as support for its view that "derogations" from Article I:1 exist only where provided for explicitly.<sup>91</sup> India emphasizes that paragraph 2(a) of the Enabling Clause does *not* specifically state that developing countries waive their rights to MFN treatment. Moreover, the object and purpose of the Enabling Clause, as well as its drafting history, indicate that

the developing countries did not agree to relinquish their MFN rights as between themselves in agreeing to paragraph 2(a) of the Enabling Clause.

48. India contends that the Drug Arrangements are not "non-discriminatory preferences beneficial to the developing countries" within the meaning of footnote 3 of the Enabling Clause. First, India relies on dictionary definitions to ascertain that the ordinary meaning of "non-discriminatory preferences" in footnote 3 is "preferential tariff treatment that is applied equally".<sup>92</sup> Secondly, India finds "contextual guidance"<sup>93</sup> on the meaning of "non-discriminatory" in Articles I, XIII, and XVII of the GATT 1994. According to India, these provisions confirm that "non-discrimination" refers to the provision of "equal competitive opportunities" in relation to non-tariff measures and of "formally equal" treatment in relation to tariff measures.<sup>94</sup> In addition, in India's submission, the inclusion of the word "unjustifiable" before the word "discrimination" in the chapeau of Article XX of the GATT 1994 demonstrates that a Member's reasons for distinguishing between products of different origin are not relevant to whether such distinction constitutes discrimination.

49. Turning to the words "generalized" and "non-reciprocal" in footnote 3, India argues that the word "generalized" refers to the countries that should be included *ab initio* as beneficiaries under a GSP scheme, whereas the word "non-discriminatory" refers to the treatment of products originating in beneficiary countries. Even if "generalized" meant that all developing countries must be included *ab initio* as beneficiaries, in India's view, the "additional requirement"<sup>95</sup> imposed by the word "non-discriminatory" would still be relevant in addressing the separate question of how products from beneficiary countries should be treated. India contests the European Communities' argument that the Panel's interpretation of "non-discriminatory" renders redundant the word "non-reciprocal" in footnote 3. India suggests that reciprocity is a "principle of trade negotiations"<sup>96</sup>, whereas "non-discriminatory" addresses the implementation of the results of such negotiations. India argues that Part IV of the GATT 1994 (entitled "Trade and Development") was added to the original GATT provisions because it is possible to comply with the principle of non-discrimination while insisting on non-reciprocity in negotiations.

<sup>92</sup> India's appellee's submission, para. 106.

<sup>93</sup> *Ibid.*, para. 115.

<sup>94</sup> *Ibid.*, paras. 118 and 120 (referring to Appellate Body Report, *EC – Bananas III*, paras. 190-191). (See also, *ibid.*, paras. 170 and 180)

<sup>95</sup> *Ibid.*, para. 148.

<sup>96</sup> *Ibid.*, para. 153.

<sup>88</sup> India's appellee's submission, para. 74 (referring to DSU, Arts. 3.3-3.4 and 3.7).

<sup>89</sup> *Ibid.*, para. 73.

<sup>90</sup> *Ibid.*, para. 1.

<sup>91</sup> *Ibid.*, paras. 93-94 (referring to Appellate Body Report, *Canada – Autos*, para. 84; and Appellate Body Report, *EC – Bananas III*, paras. 190-191).

50. India contends that paragraph 2(a) of the Enabling Clause and Article I:1 of the GATT 1994 must be interpreted in a harmonious manner so as to give effect to both provisions.<sup>97</sup> With this in mind, India submits that the Enabling Clause should be interpreted to authorize only those deviations from the MFN principle that are necessary in order for GSP schemes to operate. Thus, the Enabling Clause authorizes developed-country Members to exclude other developed countries from their GSP schemes, because Members could not grant any tariff preferences under these schemes if such exclusion was not authorized. However, in India's view, the Enabling Clause does not authorize tariff preferences that differentiate between developing countries, as tariff preferences under GSP schemes can be and are granted to developing countries without differentiation of this kind. According to India, a contrary interpretation would be inconsistent with the need to interpret paragraph 2(a) and Article I:1 so as to avoid conflict between the two provisions.

51. India derives support for its interpretation from several provisions of the Enabling Clause. In particular, India reads paragraphs 2(a) and 2(d) together as identifying three categories of countries: the developed countries, the developing countries, and the least-developed countries. In India's view, under the Enabling Clause, the developed countries "relinquished" their MFN rights in respect of preferential tariff treatment in favour of developing and least-developed countries, whereas the developing countries "relinquished" their MFN rights only in respect of preferential treatment in favour of least-developed countries.<sup>98</sup> However, India sees nothing in the text of the Enabling Clause to indicate that developing countries have similarly relinquished their MFN rights in relation to preferential treatment accorded by developed countries to other developing countries. India suggests that the European Communities itself recognized this fact prior to this dispute.<sup>99</sup> India maintains that paragraph 2(d) was specifically inserted to allow differentiation of a kind that was not previously allowed under the 1971 Waiver Decision. India argues that the European Communities' current interpretation of "non-discriminatory" in footnote 3 would render paragraph 2(d) redundant, contrary to the "principle of effectiveness in treaty interpretation".<sup>100</sup>

52. The opening words of paragraph 3(c) demonstrate, according to India, that paragraph 3(c) of the Enabling Clause does not provide for derogations from obligations imposed under paragraph 2(a), (b), or (d). Further, unlike paragraphs 5 and 6, paragraph 3(c) does not refer to

<sup>97</sup>India's appellee's submission, para. 83 (referring to Appellate Body Report, *Korea – Dairy*, para. 81; Appellate Body Report, *Argentina – Footwear (EC)*, para. 81; and International Court of Justice, Preliminary Objections, *Right of Passage over Indian Territory (Portugal v. India)*, 1957, ICI Reports, p. 142).

<sup>98</sup>*Ibid.*, paras. 3 and 5.

<sup>99</sup>*Ibid.*, para. 6 (referring to "User's Guide to the European Union's Scheme of Generalised Tariff Preferences" (February 2003) (Exhibit India-1 submitted by India to the Panel)).

<sup>100</sup>*Ibid.*, para. 132 (referring to Appellate Body Report, *US – Gasoline*, p. 23, DSR 1996:1, at 21).

"individual" or "particular" needs of developing countries. India argues that this shows that the "needs" intended by the drafters under paragraph 3(c) are the needs of "developing countries as a whole".<sup>101</sup>

53. India draws support for its reading of paragraph 2(a) from the object and purpose of the Enabling Clause. According to India, the purpose includes: facilitating "mutually acceptable arrangements"<sup>102</sup> that were "unanimous[ly] agree[d]"<sup>103</sup> in UNCTAD; replacing "special preferences"<sup>104</sup> granted only to some developing countries with generalized preferences that do not differentiate between developing countries; and, promoting the trade of developing countries without raising barriers to or creating undue difficulties for the trade of other Members, as confirmed in paragraph 3(a). India points to several UNCTAD texts to confirm these purposes<sup>105</sup>, arguing that the European Communities offers no such support for its contrary views. India regards differentiation between developing countries under a GSP scheme as inconsistent with paragraph 3(a) because it creates difficulties for the trade of other developing countries by "divert[ing] competitive opportunities"<sup>106</sup> from one country to another. In addition, India contends that linking GSP benefits to "the situation or policies"<sup>107</sup> of beneficiaries reduces the certainty and value of such benefits.

54. India contends that the European Communities' interpretation of paragraph 3(c) would mean that developed countries "would have the obligation"<sup>108</sup> to differentiate between developing countries according to their individual needs. This would have the "absurd consequence"<sup>109</sup> that a measure eliminating tariffs on products from *all* least-developed countries, without differentiating between those countries would be open to challenge under paragraph 3(c). Moreover, India argues that it would result not only in the European Communities' scheme, but in all GSP schemes being inconsistent with the Enabling Clause because they do not differentiate between developing countries based on their *individual* development needs. India also maintains that the European Communities' suggestion that its interpretation would best fulfil the objectives of paragraph 3(c) is inconsistent with

<sup>101</sup>India's appellee's submission, para. 124.

<sup>102</sup>*Ibid.*, paras. 95 and 190.

<sup>103</sup>*Ibid.*, para. 165.

<sup>104</sup>*Ibid.*, paras. 147 and 190.

<sup>105</sup>*Ibid.*, paras. 158-184 (referring to Agreed Conclusions; Resolution 21(II); Resolution 24(II) of the Second Session of UNCTAD; Charter of Algiers, paras. (a) and (d); and OECD Special Report, part II).

<sup>106</sup>*Ibid.*, para. 192.

<sup>107</sup>*Ibid.*, para. 21.

<sup>108</sup>*Ibid.*, para. 14. (original italics)

<sup>109</sup>*Ibid.*, para. 15.

the rule that treaty interpretation should be based on the text and not on policy considerations that are not reflected in the text.

55. For these reasons, India requests the Appellate Body to uphold the Panel's finding that the Drug Arrangements are not justified under the Enabling Clause.

### C. *Arguments of the Third Participants*

#### 1. Andean Community

56. The governments of Bolivia, Colombia, Ecuador, Peru, and Venezuela (jointly, the "Andean Community") submit that the Panel erred in finding that the Enabling Clause is an "exception" to Article I:1 of the GATT 1994 and in finding that Article I:1 applies concurrently with the Enabling Clause. The Andean Community also contends that, contrary to the Panel's finding, the Drug Arrangements are consistent with the Enabling Clause. Accordingly, the Andean Community supports the European Communities' contention that the Drug Arrangements are "fully WTO-compatible".<sup>110</sup>

57. The Andean Community argues that the Enabling Clause establishes "a self-standing regime"<sup>111</sup>, meaning that Article I:1 of the GATT 1994 does not apply to GSP schemes.<sup>112</sup> According to the Andean Community, the ordinary meaning of the word "notwithstanding" in paragraph 1 of the Enabling Clause confirms this interpretation, as do the context, and object and purpose of the Enabling Clause. In addition, the "history, ... practice and ... current role"<sup>113</sup> of the Enabling Clause indicate that GSP schemes provide the "most concrete and relevant form"<sup>114</sup> of special and differential treatment. This supports the concept of the Enabling Clause as a self-standing regime. According to the Andean Community, because measures falling within the Enabling Clause are to be judged solely under the Enabling Clause, India was required to make a claim under the Enabling Clause. As India did not do so, the Andean Community maintains, India's claim should be dismissed.

58. The Andean Community submits further that, even if the Enabling Clause is an exception to Article I:1, this characterization is not determinative of which party bears the burden of proof. The Andean Community asserts that the Panel erred in assigning the burden. According to the Andean

<sup>110</sup>Andean Community's third participant's submission, para. 97.

<sup>111</sup>See, for example, *ibid.*, paras. 8, 12, and 27.

<sup>112</sup>*Ibid.*, para. 9 (referring to Appellate Body Report, *Brazil – Aircraft*, para. 139).

<sup>113</sup>*Ibid.*, para. 13.

Community, under the Panel's allocation of the burden of proof, every GSP scheme would be open to challenge, with the burden falling on each preference-granting country to establish the consistency of its GSP scheme with the Enabling Clause. The Andean Community claims that the assigning of the burden of proof is "a fundamental initial decision upon which every further consideration is based", such that the Appellate Body "should reverse on this element alone".<sup>115</sup>

59. Regarding the consistency of the Drug Arrangements with the Enabling Clause, the Andean Community submits, first, that the Panel did not properly interpret the historical texts serving as context and preparatory work for the Enabling Clause. The Andean Community emphasizes the "aspirational tone"<sup>116</sup> of these texts and argues that the Panel "mischaracterize[d]"<sup>117</sup> certain texts as binding or reflecting "unanimous agreement".<sup>118</sup> Secondly, turning to the interpretation of the term "non-discriminatory" in the Enabling Clause, the Andean Community contends that the Panel wrongly equated this concept with MFN treatment. The Andean Community further alleges that the Panel's allowance for *a priori* limitations under the Enabling Clause is contrary to the Panel's own interpretation of "non-discriminatory".

60. In the view of the Andean Community, "a prohibition of discrimination is a command not to treat equal situations differently, or different situations equally"<sup>119</sup> and, accordingly, the word "non-discriminatory" in the Enabling Clause does not require that identical treatment be granted to all developing countries. The Andean Community suggests that differentiating between developing countries—taking into account their objectively different situations—does not constitute discrimination. The Andean Community argues that the "production and trafficking of illicit drugs have far-reaching, unparallelled and unquantifiable implications for the economic and social development"<sup>120</sup> of affected developing countries. By providing preferential access for "alternative products"<sup>121</sup> and, thereby, seeking to reduce the importance of drugs as an economic activity, the European Communities responds to these countries' specific needs. The Andean Community asserts that this response is consistent with the requirements of the Enabling Clause.

<sup>114</sup>*Ibid.*, para. 21.

<sup>115</sup>Andean Community's third participant's submission, para. 41.

<sup>116</sup>*Ibid.*, para. 50.

<sup>117</sup>*Ibid.*, para. 56. (original underlining)

<sup>118</sup>*Ibid.*, para. 55.

<sup>119</sup>*Ibid.*, para. 64.

<sup>120</sup>*Ibid.*, para. 78.

<sup>121</sup>*Ibid.*, para. 87.

2. Costa Rica

61. Costa Rica submits that the Panel erred in finding that the Drug Arrangements are not justified under the Enabling Clause. Costa Rica asserts that the Panel based this finding on erroneous interpretations of the terms "non-discriminatory" and "developing countries" contained in footnote 3 and paragraph 2(a), respectively, of the Enabling Clause. Accordingly, Costa Rica supports the European Communities' request that the Appellate Body reverse this finding.

62. Costa Rica contends that, instead of relying on the ordinary meaning of these terms of the Enabling Clause in context, the Panel relied on other instruments that "cannot be properly considered context for the interpretation of the Enabling Clause".<sup>122</sup> Costa Rica maintains that this led to the Panel's incorrect finding that "non-discriminatory" treatment under footnote 3 of the Enabling Clause is synonymous with identical or unconditional treatment. Costa Rica asserts that had the Panel interpreted the Enabling Clause in accordance with Article 31 of the *Vienna Convention*—in the light of the object and purpose of the Enabling Clause and the 1971 Waiver Decision—it would have found that "the 'non-discriminatory' standard prohibits developed countries from according tariff preferences that make an unjust or prejudicial distinction between different categories of developing countries."<sup>123</sup>

63. In addition, according to Costa Rica, the Panel erred in concluding that the term "developing countries" in paragraph 2(a) of the Enabling Clause means *all* developing countries. In Costa Rica's view, in interpreting this term, the Panel relied on its incorrect interpretation of the term "non-discriminatory" and failed to examine paragraph 1 of the Enabling Clause as relevant context. Moreover, Costa Rica is of the opinion that it is not appropriate to consider the *travaux préparatoires* as a supplementary means of interpretation under Article 32 of the *Vienna Convention* in interpreting paragraph 2(a). However, even if this were appropriate, the drafting history of the 1971 Waiver Decision confirms that the term "developing countries" means less than all developing countries.

3. Panama

64. Panama submits that the Panel erred in finding that the Enabling Clause is an "exception" to Article I:1 of the GATT 1994. Panama maintains that the Enabling Clause is "*per se* an autonomous rule"<sup>124</sup> that permits the granting of more favourable treatment to developing countries. Panama also contests the Panel's finding that the Drug Arrangements are incompatible with the Enabling Clause.

<sup>122</sup>Costa Rica's third participant's submission, para. 6.

<sup>123</sup>*Ibid.*, para. 15.

<sup>124</sup>Panama's third participant's submission, para. 4.

In particular, Panama argues that the Panel erred in interpreting the term "non-discriminatory" in footnote 3 of the Enabling Clause as requiring preference-granting countries to accord identical treatment to all developing countries. Panama therefore states that it is "completely in agreement with the arguments by the European Communities."<sup>125</sup>

65. Panama is of the view that, if the Enabling Clause were an exception to Article I of the GATT 1994, it would be included as a waiver decision in the GATT 1994.<sup>126</sup> Because the Enabling Clause is not so included, Panama contends, it is an "independent" and "special" rule governing the differential and more favourable treatment accorded to developing countries under the schemes set out in paragraph 2 of the Enabling Clause.<sup>127</sup> Panama submits that "the Enabling Clause creates a standalone mechanism that is linked to the general principle contained in GATT Article I:1"<sup>128</sup> and, as such, constitutes an "autonomous right"<sup>129</sup> of WTO Members.

66. Panama argues that the Enabling Clause is not an affirmative defence but, rather, "excludes the application of ... Article I:1".<sup>130</sup> As such, Panama claims, it was up to India to claim that the Drug Arrangements do not fall within the scope of paragraph 2(a) of the Enabling Clause and are inconsistent with paragraph 3(c) thereof. Because India did not do so, Panama argues, the Appellate Body should refrain from assessing the consistency of the Drug Arrangements with the Enabling Clause.

67. According to Panama, "non-discrimination" does not mean equal treatment. Panama submits that the fact that the Drug Arrangements are not extended to all developing countries does not mean that they discriminate between developing countries. In addition, Panama maintains that the obligation imposed in paragraph 3(c) of the Enabling Clause must be interpreted in order to allow some flexibility for preference-granting countries to provide preferential treatment that "effectively help[s] 'generalized' needs".<sup>131</sup> In this respect, Panama claims, the Drug Arrangements satisfy the "requirement" in paragraph 3(c) because they respond to "specific growth needs".<sup>132</sup>

<sup>125</sup>Panama's third participant's submission, para. 1.

<sup>126</sup>Paragraph 1(b)(iii) of the language of Annex 1A incorporating the GATT 1994 into the *WTO Agreement*.

<sup>127</sup>Panama's third participant's submission, paras. 5-6.

<sup>128</sup>*Ibid.*, para. 10.

<sup>129</sup>*Ibid.*, para. 8.

<sup>130</sup>*Ibid.*, para. 17.

<sup>131</sup>*Ibid.*, para. 23.

<sup>132</sup>*Ibid.*, para. 13.

4. Paraguay

68. Paraguay contends that the Panel was correct in finding that the Enabling Clause is an "exception" to Article I:1 of the GATT 1994. In addition, Paraguay agrees with the Panel's interpretation of paragraph 2(a) of the Enabling Clause and the Panel's consequent finding that the Drug Arrangements are not justified by the Enabling Clause. Accordingly, Paraguay supports India's request that the Appellate Body uphold these findings.

69. According to Paraguay, where a Member's measure differentiates between other Members in a manner inconsistent with Article I:1 and does not fall within any specific exceptions such as the Enabling Clause or Article XX of the GATT 1994, the only way for that Member to impose its measure in accordance with its WTO obligations is to seek a waiver under Article IX of the *WTO Agreement*. Paraguay maintains that the Drug Arrangements are inconsistent with Article I:1 and that the European Communities has received no such waiver in respect of them.

70. Paraguay contests the European Communities' characterization of the Enabling Clause as a "different, parallel legal regime".<sup>133</sup> Paraguay maintains that Article I:1 forms the "primary basis" for WTO trade and that exceptions to Article I:1 must be founded on "properly established legal rules".<sup>134</sup> In Paraguay's view, the Enabling Clause is an exception to Article I:1 and is a part of the GATT 1994, and the GSP recognized in the Enabling Clause is "a permanent mechanism of the rules-based multilateral trading system".<sup>135</sup>

71. Paraguay emphasizes that developing countries did not renounce their right to MFN treatment under Article I:1 of the GATT 1994 in agreeing to the Enabling Clause. According to Paraguay, the Enabling Clause was adopted to replace the "special preferences"<sup>136</sup> provided by developed countries to certain developing countries, with a generalized system under which all developing countries would benefit. Paraguay argues that the only distinction that the WTO draws within the category of developing countries is in recognizing the category of least-developed countries, as explicitly stated in paragraph 2(d) of the Enabling Clause. As such, in Paraguay's view, the "condition"<sup>137</sup> of non-discrimination in footnote 3 means that benefits granted to some developing countries must be granted

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<sup>133</sup>Paraguay's third participant's submission, para. 13.

<sup>134</sup>*Ibid.*, para. 12.

<sup>135</sup>*Ibid.*, para. 11.

<sup>136</sup>*Ibid.*, para. 14.

<sup>137</sup>*Ibid.*, para. 27.

to all such countries. Therefore, Paraguay submits that tariff preferences pursuant to the Enabling Clause must apply to all developing countries.

5. United States

72. The United States contends that the Panel misconceived the relationship between the Enabling Clause and Article I:1 of the GATT 1994. The United States also submits that the Panel erred in concluding that the term "non-discriminatory" in footnote 3 of the Enabling Clause requires preference-granting countries to accord "identical" treatment to all beneficiaries and that, consequently, paragraph 2(a) covers only identical preferences extended to *all* developing countries. Accordingly, the United States supports the European Communities' request that the Appellate Body reverse the Panel's legal interpretation of the terms "non-discriminatory" in footnote 3 and "developing countries" in paragraph 2(a) and, consequently, reverse the Panel's finding that the Enabling Clause is an "exception" to Article I:1.

73. Beginning with the relationship between Article I:1 and the Enabling Clause, the United States claims that the Panel failed to consider the entire text of the Enabling Clause and the context and object and purpose of the Enabling Clause and of the GATT 1994. The United States argues that the Panel "misconstru[ed]" the statement of the Appellate Body in *US – Wool Shirts and Blouses* and applied this statement "as a mechanical test" without due regard to the term "notwithstanding" in the Enabling Clause.<sup>138</sup> The United States observes that the Panel examined the ordinary meaning of "notwithstanding" in paragraph 1 of the Enabling Clause only after the Panel had concluded that the Enabling Clause is an "exception". In addition, in the view of the United States, the reasoning underlying the Panel's conclusion that the Enabling Clause is an exception "would result in ... inconsistencies and absurd results"<sup>139</sup> because several WTO obligations apply only if a Member chooses to take the action addressed in the relevant provision.

74. The United States submits that the Enabling Clause is part of the overall balance of rights and obligations in the covered agreements and, as such, is a "separate provision authorizing the types of treatment provided therein", "in spite of" the MFN obligation in Article I:1.<sup>140</sup> In other words, the United States maintains that, contrary to the finding of the Panel, the Enabling Clause is a "positive rule establishing obligations in itself".<sup>141</sup> The United States emphasizes that several aspects of the Enabling Clause are unrelated to Article I:1 and that the Enabling Clause is incorporated into the

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<sup>138</sup>United States' third participant's submission, paras. 2-3.

<sup>139</sup>*Ibid.*, para. 5.

<sup>140</sup>*Ibid.*, paras. 3 and 10.

<sup>141</sup>*Ibid.*, para. 4.

GATT 1994. The United States also argues that, unlike Article XX of the GATT 1994, the Enabling Clause "encourages"<sup>142</sup> developed-country Members to grant preferences to developing-country Members. In the view of the United States, "[p]lacing the burden on developed countries to defend actions they take to benefit developing countries ... would create a *disincentive* for developed countries" to take such action.<sup>143</sup>

75. Turning to footnote 3 of the Enabling Clause, the United States contests the Panel's "assum[ption]"<sup>144</sup> that the term "non-discriminatory" in footnote 3 imposes obligations on preference-granting countries. In the view of the United States, "[t]his footnote is simply a cross-reference to where the Generalized System of Preferences is described."<sup>145</sup> Because the Panel began its analysis "from a false premise", the United States suggests that the Panel's finding as to footnote 3 "should be rejected on that basis alone".<sup>146</sup> In any case, the United States contends, the Panel erroneously arrived at a "one size fits all"<sup>147</sup> obligation to grant "identical" tariff preferences to "all" developing countries. Furthermore, according to the United States, the fact that the Panel understood the Enabling Clause to allow *a priori* limitations demonstrates that the term "non-discriminatory" does not preclude all conditions. The United States asserts that the Panel focused not on the text, but on a policy concern—the prevention of "abuse"<sup>148</sup> by preference-granting countries. In the United States' view, the Panel's focus on this policy concern is inconsistent with Article 3.2 of the DSU and led to an incorrect interpretation of "non-discriminatory".

76. With respect to paragraph 3(c) of the Enabling Clause, the United States argues that the Panel wrongly interpreted this provision as imposing an obligation not to provide differentiated GSP benefits. In doing so, the United States submits, the Panel failed to recognize that the term "generalized" in footnote 3 ensures that the responses of preference-granting countries to the needs of developing countries do not result in tariff advantages accorded primarily to select countries.

77. Finally, the United States contends that the Panel's interpretation of "developing countries" in paragraph 2(a) as referring to all developing countries is "completely dependent"<sup>149</sup> on its erroneous interpretation of "non-discriminatory". Moreover, the United States argues, the Enabling Clause

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<sup>142</sup>United States' third participant's submission, para. 8. (original italics)

<sup>143</sup>*Ibid.*, para. 9. (original italics)

<sup>144</sup>*Ibid.*, para. 11.

<sup>145</sup>*Ibid.*

<sup>146</sup>*Ibid.*

<sup>147</sup>*Ibid.*, para. 22.

<sup>148</sup>*Ibid.*, para. 20 (quoting Panel Report, para. 7.158).

<sup>149</sup>*Ibid.*, para. 23.

refers only to "developing countries" or "the developing countries", and not to "all developing countries".<sup>150</sup>

### III. Issues Raised in This Appeal

78. The following issues are raised in this appeal:

- (a) Whether the Panel erred in concluding that the "special arrangements to combat drug production and trafficking" (the "Drug Arrangements"), which are part of Council Regulation (EC) No. 2501/2001 (the "Regulation")<sup>151</sup>, are inconsistent with Article I:1 of the *General Agreement on Tariffs and Trade 1994* (the "GATT 1994")<sup>152</sup>, based on the Panel's findings that:
  - (i) the Decision on Differential and More Favourable Treatment, Reciprocity, and Fuller Participation of Developing Countries (the "Enabling Clause")<sup>153</sup> is an "exception"<sup>154</sup> to Article I:1 of the GATT 1994;
  - (ii) the Enabling Clause "does not exclude the applicability"<sup>155</sup> of Article I:1 of the GATT 1994; and
  - (iii) the European Communities bears the burden of invoking the Enabling Clause and proving that the Drug Arrangements are consistent with that Clause<sup>156</sup>; and
- (b) Whether the Panel erred in concluding that the European Communities failed to prove that the Drug Arrangements are justified under paragraph 2(a) of the Enabling Clause<sup>157</sup>, based on the Panel's findings that:

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<sup>150</sup>United States' third participant's submission, para. 24. (original italics)

<sup>151</sup>Council Regulation (EC) No. 2501/2001 of 10 December 2001 applying a scheme of generalised tariff preferences for the period from 1 January 2002 to 31 December 2004, *Official Journal of the European Communities*, L Series, No. 346 (31 December 2001), p. 1 (Exhibit India-6 submitted by India to the Panel).

<sup>152</sup>Panel Report, paras. 7.60 and 8.1(b).

<sup>153</sup>GATT Document L/4903, 28 November 1979, BISD 26S/203 (attached as Annex 2 to this Report).

<sup>154</sup>Panel Report, para. 7.53.

<sup>155</sup>*Ibid.*

<sup>156</sup>*Ibid.*

<sup>157</sup>*Ibid.*, para. 8.1(d).

- (i) the term "non-discriminatory" in footnote 3 to paragraph 2(a) of the Enabling Clause requires that, pursuant to schemes under the Generalized System of Preferences ("GSP"), "identical tariff preferences"<sup>158</sup> be provided to all developing countries without differentiation, except as regards the implementation of *a priori* limitations; and
- (ii) the term "developing countries" in paragraph 2(a) of the Enabling Clause means "all"<sup>159</sup> developing countries, except as regards the implementation of *a priori* limitations.

#### IV. The Relationship Between Article I:1 of the GATT 1994 and the Enabling Clause

79. We begin our analysis of the European Communities' appeal by examining its claim that the Panel improperly characterized the relationship between Article I:1 of the GATT 1994 and the Enabling Clause, and thus improperly allocated the burden of proof in this dispute.

##### A. *The Panel's Analysis and the Arguments on Appeal*

80. The Panel observed that the participants disagree on whether the Enabling Clause constitutes a "positive rule setting out obligations", or an "exception" authorizing derogation from one or more such positive rules.<sup>160</sup> Based on its understanding of the Appellate Body's decision in *US – Wool Shirts and Blouses*, the Panel determined that the Enabling Clause, in and of itself, does not establish legal obligations but, instead, contains requirements that are "only subsidiary obligations, dependent on the decision of the Member to take [particular] measures".<sup>161</sup> The Panel further concluded that the legal function of the Enabling Clause is to permit Members to derogate from Article I:1 "so as to enable developed countries, *inter alia*, to provide GSP to developing countries".<sup>162</sup> As a result, the Panel found that the Enabling Clause is "in the nature of an exception" to Article I:1.<sup>163</sup>

81. The Panel noted that the GATT 1994 includes several provisions in the nature of exceptions that serve to justify a measure's inconsistency with Article I:1, including Articles XX, XXI, and XXIV, and the Enabling Clause. According to the Panel, these exceptions reflect "legitimate

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<sup>158</sup>Panel Report, para. 7.161.

<sup>159</sup>*Ibid.*, para. 7.176.

<sup>160</sup>*Ibid.*, para. 7.32.

<sup>161</sup>*Ibid.*, para. 7.37.

<sup>162</sup>*Ibid.*, para. 7.38.

<sup>163</sup>*Ibid.*, para. 7.39.

objectives" that may be pursued by Members.<sup>164</sup> The Panel reasoned that, because a complaining party may not be able to discern the objectives of a given measure, particularly as they may not be apparent from the text of the measure itself, it is "sufficient" for a complaining party to demonstrate an inconsistency with Article I:1, without also establishing "violations" of any of the possible exception provisions.<sup>165</sup>

82. With respect to the present dispute, the Panel found that India could make its case against the European Communities solely by establishing the inconsistency of the Drug Arrangements with Article I:1.<sup>166</sup> Having done so, according to the Panel, it would then be incumbent upon the European Communities to invoke the Enabling Clause as a defence and to demonstrate the consistency of the Drug Arrangements with the requirements contained in that Clause.<sup>167</sup>

83. The Panel also examined whether Article I:1 applies to a measure covered by the Enabling Clause. It looked first to the ordinary meaning of the term "notwithstanding", as used in paragraph 1 of the Enabling Clause, and concluded on that basis that the Enabling Clause takes precedence over Article I "to the extent of conflict between the two provisions".<sup>168</sup> Nevertheless, the Panel declined to assume the exclusion of the applicability of a "basic GATT obligation" such as Article I:1 in the absence of a textual indication of Members' intent to that effect.<sup>169</sup> Thus, it also referred to World Trade Organization ("WTO") jurisprudence relating to other exception provisions, and concluded that the relationship between these exceptions and the obligations from which derogation is permitted is "one where both categories of provisions apply concurrently to the same measure, but where, in the case of conflict between these two categories of provisions, [the exception] prevails".<sup>170</sup> Accordingly, the Panel concluded, on the basis of both the ordinary meaning of the text of the provision and WTO case law, that Article I:1 applies to measures covered by the Enabling Clause and that the Enabling Clause prevails over Article I:1 "to the extent of the conflict between [them]".<sup>171</sup>

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<sup>164</sup>Panel Report, para. 7.40.

<sup>165</sup>*Ibid.*

<sup>166</sup>*Ibid.*

<sup>167</sup>*Ibid.*, para. 7.42.

<sup>168</sup>*Ibid.*, para. 7.44. Paragraph 1 of the Enabling Clause provides:

Notwithstanding the provisions of Article I of the General Agreement, contracting parties may accord differential and more favourable treatment to developing countries, without according such treatment to other contracting parties. (footnote omitted)

<sup>169</sup>Panel Report, para. 7.44.

<sup>170</sup>*Ibid.*, para. 7.45.

<sup>171</sup>*Ibid.*

84. Finally, the Panel referred to the European Communities' reliance on the Appellate Body's decisions in *Brazil – Aircraft* and *EC – Hormones* and distinguished those cases from the present dispute. The Panel stated that the relationship between the provisions at issue in those cases was "different" from the relationship it had found between Article I:1 and the Enabling Clause.<sup>172</sup> In particular, the Panel determined that, in the two earlier disputes, one provision "clearly exclude[d]" the application of the other.<sup>173</sup> In contrast, the Panel had already found that the Enabling Clause does not exclude the applicability of Article I:1. In these circumstances, the Panel suggested that the Enabling Clause constitutes an "affirmative defence", in relation to which the responding party bears the burden of proof if that party invokes the Enabling Clause to justify its challenged measure.<sup>174</sup>

85. On appeal, the European Communities challenges the Panel's finding that the Enabling Clause is an "exception"<sup>175</sup> to Article I:1 of the GATT 1994 and that, therefore, the European Communities must invoke the Enabling Clause as an "affirmative defence"<sup>176</sup> to India's claim that the Drug Arrangements are inconsistent with Article I:1. The European Communities submits that the Enabling Clause is part of a "special regime for developing countries"<sup>177</sup>, which "encourages"<sup>178</sup>, *inter alia*, the granting of tariff preferences by developed-country Members to developing countries. As a result, the Enabling Clause exists "side-by-side and on an equal level" with Article I:1, and applies to the *exclusion* thereof, rather than as an exception thereto.<sup>179</sup> The European Communities argues, therefore, that India is required to bring a claim under the Enabling Clause if it considers that the European Communities' GSP scheme has nullified or impaired India's rights.<sup>180</sup> The European Communities requests us to refrain from examining the consistency of the Drug Arrangements with the requirements of the Enabling Clause because, according to the European Communities and as

<sup>172</sup>Panel Report, paras. 7.48-7.50.

<sup>173</sup>*Ibid.*, para. 7.48. (See also, *ibid.*, paras. 7.47-7.50) The Panel was referring to Articles 3.1(a) and 27.2(b) of the *Agreement on Subsidies and Countervailing Measures* (the "SCM Agreement"), as interpreted in Appellate Body Report, *Brazil – Aircraft*, and Articles 3.1 and 3.3 of the *Agreement on the Application of Sanitary and Phytosanitary Measures* (the "SPS Agreement"), as interpreted in Appellate Body Report, *EC – Hormones*.

<sup>174</sup>Panel Report, para. 7.49.

<sup>175</sup>*Ibid.*, para. 7.39.

<sup>176</sup>*Ibid.*, para. 7.42.

<sup>177</sup>European Communities' appellant's submission, para. 51.

<sup>178</sup>*Ibid.*, para. 53.

<sup>179</sup>*Ibid.*, para. 22.

<sup>180</sup>*Ibid.*, para. 15(2).

allegedly acknowledged by India before the Panel, India did not bring a claim under the Enabling Clause.<sup>181</sup>

86. India, by contrast, supports the Panel's understanding of the relationship between Article I:1 and the Enabling Clause. India argues that paragraph 2(a) of the Enabling Clause qualifies as an "exception" because the conditions therein must be complied with only by Members adopting a measure pursuant to the authorization granted by that provision. This differs from the most-favoured nation ("MFN") obligation in Article I:1.<sup>182</sup> Moreover, according to India, we are not precluded from addressing the consistency of the Drug Arrangements with the Enabling Clause because, contrary to the assertion of the European Communities, India did make a claim under that Clause before the Panel.<sup>183</sup> India submits that denying the Panel the "competence"<sup>184</sup> to evaluate this claim, even if the Enabling Clause is not regarded as an exception, would be inconsistent with the objectives of WTO dispute settlement, "namely to secure a 'prompt' and 'positive solution to a dispute', and 'achieve a satisfactory settlement of the matter' in accordance with rights and obligations under the covered agreements."<sup>185</sup> According to India, this is particularly so because the European Communities had been on notice throughout the Panel proceedings of India's position that the Drug Arrangements are not justified by the Enabling Clause.<sup>186</sup>

B. *Relevance of the Relationship Between Article I:1 of the GATT 1994 and the Enabling Clause for the Allocation of the Burden of Proof*

87. We begin our analysis of the relationship between Article I:1 of the GATT 1994 and the Enabling Clause, and the attendant implications for the allocation of the burden of proof in this dispute, by recalling the observation of the Appellate Body in *US – Wool Shirts and Blouses*:

[I]t is a generally-accepted canon of evidence in civil law, common law and, in fact, most jurisdictions, that the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence.<sup>187</sup>

<sup>181</sup>European Communities' appellant's submission, paras. 3, 13(2), and 66.

<sup>182</sup>India's appellee's submission, paras. 36 and 39.

<sup>183</sup>*Ibid.*, paras. 54-57.

<sup>184</sup>*Ibid.*, para. 71 and heading II.B.3.

<sup>185</sup>*Ibid.*, para. 74 (quoting DSU, Arts. 3.3, 3.4, and 3.7). (footnotes omitted)

<sup>186</sup>*Ibid.*, para. 73.

<sup>187</sup>Appellate Body Report, *US – Wool Shirts and Blouses*, p. 14, DSR 1997:1, at 335.

It is thus for the *complaining* party to raise a claim with respect to a particular obligation and to *prove* that the responding party is acting inconsistently with that obligation. It is for the *responding* party, if it so chooses, to raise a defence in response to an allegation of inconsistency and to *prove* that its challenged measure satisfies the conditions of that defence. Therefore, the question before us is whether India must raise a "claim" and prove that the Drug Arrangements are inconsistent with the Enabling Clause, or whether the European Communities must raise and prove, in "defence", that the Drug Arrangements are consistent with the Enabling Clause, in order to justify the alleged inconsistency of the Drug Arrangements with Article I:1.<sup>188</sup>

88. We recall that the Appellate Body has addressed the allocation of the burden of proof in similar situations. In cases where one provision permits, in certain circumstances, behaviour that would otherwise be inconsistent with an obligation in another provision, and one of the two provisions refers to the other provision, the Appellate Body has found that the complaining party bears the burden of establishing that a challenged measure is inconsistent with the provision permitting particular behaviour *only* where one of the provisions suggests that the obligation is not applicable to the said measure.<sup>189</sup> Otherwise, the permissive provision has been characterized as an exception, or defence, and the onus of invoking it and proving the consistency of the measure with its requirements has been placed on the responding party.<sup>190</sup> However, this distinction may not always be evident or readily applicable.

C. *Characterization of the Enabling Clause*

1. Text of Article I:1 and the Enabling Clause

89. In considering whether the Enabling Clause is an exception to Article I:1 of the GATT 1994, we look, first, to the text of the provisions at issue. Article I:1, which embodies the MFN principle, provides:

<sup>188</sup>We are not concerned here with the situation where a complaining party brings a challenge solely under the provisions of the Enabling Clause, that is, without also claiming an inconsistency with Article I of the GATT 1994.

<sup>189</sup>See Appellate Body Report, *EC – Hormones*, para. 104; Appellate Body Report, *Brazil – Aircraft*, paras. 139-141; and Appellate Body Report, *EC – Sardines*, para. 275.

<sup>190</sup>See Appellate Body Report, *US – FSC (Article 21.5 – EC)*, paras. 131-133; and Appellate Body Report, *US – Wool Shirts and Blouses*, p.16, DSR 1997:1, at 337.

*Article I*

*General Most-Favoured-Nation Treatment*

1. With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III,\* any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.

Article I:1 plainly imposes upon WTO Members the obligation to treat "like products ... equally, irrespective of their origin".<sup>191</sup>

90. We turn now to the Enabling Clause, which has become an integral part of the GATT 1994.<sup>192</sup> Paragraph 1 of the Enabling Clause, which applies to all measures authorized by that Clause, provides:

Notwithstanding the provisions of Article I of the General Agreement, contracting parties may accord differential and more favourable treatment to developing countries, without according such treatment to other contracting parties. (footnote omitted)

The ordinary meaning of the term "notwithstanding" is, as the Panel noted<sup>193</sup>, "[i]n spite of, without regard to or prevention by".<sup>194</sup> By using the word "notwithstanding", paragraph 1 of the Enabling

<sup>191</sup>Appellate Body Report, *EC – Bananas III*, para. 190.

<sup>192</sup>In response to questioning at the oral hearing, the participants and third participants agreed that the Enabling Clause is one of the "other decisions of the CONTRACTING PARTIES" within the meaning of paragraph 1(b)(iv) of the language of Annex 1A incorporating the GATT 1994 into the *WTO Agreement*. That provision stipulates that:

1. The General Agreement on Tariffs and Trade 1994 ("GATT 1994") shall consist of:

(b) the provisions of the legal instruments set forth below that have entered into force under the GATT 1947 before the date of entry into force of the WTO Agreement:

(iv) other decisions of the CONTRACTING PARTIES to GATT 1947[.]

<sup>193</sup>See Panel Report, para. 7.44.

<sup>194</sup>*Shorter Oxford English Dictionary*, 5th ed., W.R. Trumble, A. Stevenson (eds.) (Oxford University Press, 2002), Vol. 2, p. 1948.

Clause permits Members to provide "differential and more favourable treatment" to developing countries "in spite of" the MFN obligation of Article I:1. Such treatment would otherwise be inconsistent with Article I:1 because that treatment is not extended to all Members of the WTO "immediately and unconditionally".<sup>195</sup> Paragraph 1 thus excepts Members from complying with the obligation contained in Article I:1 for the purpose of providing differential and more favourable treatment to developing countries, provided that such treatment is in accordance with the conditions set out in the Enabling Clause. As such, the Enabling Clause operates as an "exception" to Article I:1.

2. Object and Purpose of the *WTO Agreement* and the Enabling Clause

91. The European Communities' contention that the Enabling Clause is *not* in the nature of an exception appears to be founded on the European Communities' understanding of the object and purpose of the *Marrakesh Agreement Establishing the World Trade Organization* (the "*WTO Agreement*") and the Enabling Clause. We, too, look to the object and purpose of the *WTO Agreement* and the Enabling Clause to clarify whether the Enabling Clause was intended to operate as an exception to Article I:1.

92. The Preamble to the *WTO Agreement* provides that Members recognize:

... that there is need for *positive efforts* designed to ensure that developing countries, and especially the least developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development[.]<sup>196</sup> (emphasis added)

The Waiver Decision on the Generalized System of Preferences (the "1971 Waiver Decision")<sup>197</sup>, which provided the initial authorization under the GATT for developed countries' GSP schemes and is explicitly referred to in footnote 3 of the Enabling Clause<sup>198</sup>, offers relevant guidance in discerning the object and purpose of the Enabling Clause. In the Preamble to the 1971 Waiver Decision, the Contracting Parties recognized:

<sup>195</sup>GATT 1994, Art. I:1.

<sup>196</sup>Second recital. We note that Article XXXVI:3 of the GATT 1994 similarly provides:

There is need for positive efforts designed to ensure that less-developed contracting parties secure a share in the growth in international trade commensurate with the needs of their economic development.

<sup>197</sup>GATT Document L/3545, 25 June 1971, BISD 18S/24 (attached as Annex D-2 to the Panel Report).

<sup>198</sup>Footnote 3 of the Enabling Clause states:

As described in the Decision of the CONTRACTING PARTIES of 25 June 1971, relating to the establishment of "generalized, non-reciprocal and non-discriminatory preferences beneficial to the developing countries" (BISD 18S/24).

... that a principal aim of the CONTRACTING PARTIES is promotion of the trade and export earnings of developing countries for the furtherance of their economic development;

[and recognized] further that individual and joint action is essential to further the development of the economies of developing countries[.]<sup>199</sup>

We understand, therefore, that the Enabling Clause is among the "positive efforts" called for in the Preamble to the *WTO Agreement* to be taken by developed-country Members to enhance the "economic development" of developing-country Members.<sup>200</sup>

93. According to the European Communities, the Enabling Clause, as the "most concrete, comprehensive and important application of the principle of Special and Differential Treatment", serves "to achieve one of the fundamental objectives of the *WTO Agreement*".<sup>201</sup> In the view of the European Communities, provisions that are exceptions permit Members to adopt measures to pursue objectives that are "not ... among the *WTO Agreement*'s own objectives"<sup>202</sup>; the Enabling Clause thus does not fall under the category of exceptions. Pointing to this alleged difference between the role of measures falling under the Enabling Clause and that of measures falling under exception provisions such as Article XX, the European Communities contends that the *WTO Agreement* does not "merely tolerate" measures under the Enabling Clause, but rather "encourages" developed-country Members to adopt such measures.<sup>203</sup> According to the European Communities, to require preference-granting countries to invoke the Enabling Clause in order to justify or defend their GSP schemes cannot be reconciled with the intention of *WTO* Members to encourage these schemes.

94. We note, however, as did the Panel<sup>204</sup>, that *WTO* objectives may well be pursued through measures taken under provisions characterized as exceptions. The Preamble to the *WTO Agreement* identifies certain objectives that may be pursued by Members through measures that would have to be

<sup>199</sup>First and second recitals. Similarly, Article XXXVI:(d) of the GATT 1994 provides:

[I]ndividual and joint action is essential to further the development of the economies of less-developed contracting parties and to bring about a rapid advance in the standards of living in these countries[.]

<sup>200</sup>We discuss further the role of the Enabling Clause in the context of the covered agreements, *infra*, paras. 106-109.

<sup>201</sup>European Communities' appellant's submission, para. 20.

<sup>202</sup>*Ibid.*, para. 52.

<sup>203</sup>*Ibid.*, para. 53.

<sup>204</sup>See Panel Report, para. 7.52.

justified under the "General Exceptions" of Article XX. For instance, one such objective is reflected in the recognition by Members that the expansion of trade must be accompanied by:

... the optimal use of the world's resources in accordance with the objective of sustainable development, [with Members] seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development[.]<sup>205</sup>

95. As the Appellate Body observed in *US – Shrimp*, WTO Members retained Article XX(g) from the *General Agreement on Tariffs and Trade 1947* (the "GATT 1947") without alteration after the conclusion of the Uruguay Round, being "fully aware of the importance and legitimacy of environmental protection as a goal of national and international policy".<sup>206</sup> Article XX(g) of the GATT 1994 permits Members, subject to certain conditions, to take measures "relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption". It is well-established that Article XX(g) is an *exception* in relation to which the responding party bears the burden of proof.<sup>207</sup> Thus, by authorizing in Article XX(g) measures for environmental conservation, an important objective referred to in the Preamble to the *WTO Agreement*, Members implicitly recognized that the implementation of such measures would not be discouraged simply because Article XX(g) constitutes a defence to otherwise WTO-inconsistent measures. Likewise, characterizing the Enabling Clause as an exception, in our view, does not undermine the importance of the Enabling Clause within the overall framework of the covered agreements and as a "positive effort" to enhance economic development of developing-country Members. Nor does it "discourag[e]"<sup>208</sup> developed countries from adopting measures in favour of developing countries under the Enabling Clause.

96. The European Communities acknowledges that requiring Members to pursue environmental measures through Article XX(g), an exception provision, may be logical because "the WTO Agreement is not an environmental agreement and ... it contains no positive regulation of environmental matters."<sup>209</sup> Because the *WTO Agreement* "regulate[s] positively the use of trade

<sup>205</sup> *WTO Agreement*, Preamble, first recital.

<sup>206</sup> Appellate Body Report, *US – Shrimp*, para. 129.

<sup>207</sup> *Ibid.*, para. 157; Appellate Body Report, *US – Wool Shirts and Blouses*, pp. 15-16, DSR 1997:1, at 337 (referring to GATT Panel Report, *Canada – FIRA*, para. 5.20; GATT Panel Report, *US – Section 337*, para. 5.27; GATT Panel Report, *US – Malt Beverages*, paras. 5.43 and 5.52; and Panel Report, *US – Gasoline*, para. 6.20).

<sup>208</sup> United States' third participant's submission, para. 9.

<sup>209</sup> European Communities' appellant's submission, para. 54.

measures"<sup>210</sup>, however, and the Enabling Clause "promotes" the use of trade measures to further the development of developing countries, the European Communities argues that Members should not be required to prove the consistency of their measures with the Enabling Clause.

97. We do not consider it relevant, for the purposes of determining whether a provision is or is not in the nature of an exception, that the provision governs "trade measures" rather than measures of a primarily "non-trade" nature. Indeed, in a previous appeal, the Appellate Body found that the proviso to Article XVIII:11 of the GATT 1994—a provision authorizing quantitative restrictions when taken in response to balance-of-payments difficulties—is a defence to be invoked by the responding party.<sup>211</sup> The fact that a provision regulates the use of "trade measures", therefore, does not compel a finding that it is for the complaining party to establish inconsistency with that provision, rather than for the defending party to rely on it as a defence.

98. In sum, in our view, the characterization of the Enabling Clause as an exception in no way diminishes the right of Members to provide or to receive "differential and more favourable treatment". The status and relative importance of a given provision does not depend on whether it is characterized, for the purpose of allocating the burden of proof, as a claim to be proven by the complaining party, or as a defence to be established by the responding party. Whatever its characterization, a provision of the covered agreements must be interpreted in accordance with the "customary rules of interpretation of public international law", as required by Article 3.2 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU").<sup>212</sup> Members' rights under the Enabling Clause are not curtailed by requiring preference-granting countries to establish in dispute settlement the consistency of their preferential measures with the conditions of the Enabling Clause. Nor does characterizing the Enabling Clause as an exception

<sup>210</sup> European Communities' appellant's submission, para. 54.

<sup>211</sup> Appellate Body Report, *India – Quantitative Restrictions*, paras. 134-136. We also note that GATT panels determined Article XI:2(c) of the GATT 1947 to constitute an "exception", even though that provision addresses "trade measures", namely quantitative restrictions. (See GATT Panel Report, *Japan – Agricultural Products I*, para. 5.1.3.7; GATT Panel Report, *EEC – Dessert Apples*, para. 12.3; and GATT Panel Report, *Canada – Ice Cream and Yoghurt*, para. 59.)

<sup>212</sup> In this regard, we recall the Appellate Body's statement in *EC – Hormones* that:  
... merely characterizing a treaty provision as an "exception" does not by itself justify a "stricter" or "narrower" interpretation of that provision than would be warranted by examination of the ordinary meaning of the actual treaty words, viewed in context and in the light of the treaty's object and purpose, or, in other words, by applying the normal rules of treaty interpretation.

(Appellate Body Report, para. 104)

detract from its critical role in encouraging the granting of special and differential treatment to developing-country Members of the WTO.

99. In the light of the above, we *uphold* the Panel's finding, in paragraph 7.53 of the Panel Report, that the Enabling Clause is an "exception" to Article I:1 of the GATT 1994.

100. We examine now the European Communities' appeal regarding the Panel's finding that the Enabling Clause "does not exclude the applicability" of Article I:1 of the GATT 1994.<sup>213</sup> The European Communities argues that the Enabling Clause exists "side-by-side and on an equal level" with Article I:1, and thus applies to the exclusion of that provision.<sup>214</sup> In our view, the European Communities misconstrues the relationship between the two provisions.

101. It is well settled that the MFN principle embodied in Article I:1 is a "cornerstone of the GATT" and "one of the pillars of the WTO trading system"<sup>215</sup>, which has consistently served as a key basis and impetus for concessions in trade negotiations. However, we recognize that Members are entitled to adopt measures providing "differential and more favourable treatment" under the Enabling Clause. Therefore, challenges to such measures, brought under Article I:1, cannot succeed where such measures are in accordance with the terms of the Enabling Clause. In our view, this is so because the text of paragraph 1 of the Enabling Clause ensures that, to the extent that there is a conflict between measures under the Enabling Clause and the MFN obligation in Article I:1, the Enabling Clause, as the more specific rule, prevails over Article I:1. In order to determine whether such a conflict exists, however, a dispute settlement panel should, as a first step, examine the consistency of a challenged measure with Article I:1, as the general rule. If the measure is considered at this stage to be inconsistent with Article I:1, the panel should then examine, as a second step, whether the measure is nevertheless justified by the Enabling Clause. It is only at this latter stage that a final determination of consistency with the Enabling Clause or inconsistency with Article I:1 can be made.

<sup>213</sup>Panel Report, para. 7.53.

<sup>214</sup>European Communities' appellant's submission, para. 22.

<sup>215</sup>Appellate Body Report, *Canada – Autos*, para. 69. See also, Appellate Body Report, *US – Section 211 Appropriations Act*, para. 297, which reads:

Like the national treatment obligation, the obligation to provide most-favoured-nation treatment has long been one of the cornerstones of the world trading system. For more than fifty years, the obligation to provide most-favoured-nation treatment in Article I of the GATT 1994 has been both central and essential to assuring the success of a global rules-based system for trade in goods.

102. In other words, the Enabling Clause "does not exclude the applicability"<sup>216</sup> of Article I:1 in the sense that, as a matter of procedure (or "order of examination", as the Panel stated<sup>217</sup>), the challenged measure is submitted successively to the test of compatibility with the two provisions. But, as a matter of final determination—or *application* rather than *applicability*—it is clear that only one provision applies at a time. This is what the Panel itself found when, after stating that "as an exception provision, the Enabling Clause applies concurrently with Article I:1", it added "and *takes precedence* to the extent of the conflict between the two provisions."<sup>218</sup>

103. It is with this understanding, therefore, that we *uphold* the Panel's finding, in paragraph 7.53 of the Panel Report, that the Enabling Clause "does not exclude the applicability" of Article I:1 of the GATT 1994.

#### D. *Burden of Proof*

104. We now examine the implications of the relationship between Article I:1 of the GATT 1994 and the Enabling Clause for the allocation of the burden of proof in this dispute. As a general rule, the burden of proof for an "exception" falls on the respondent, that is, as the Appellate Body stated in *US – Wool Shirts and Blouses*, on the party "assert[ing] the affirmative of a particular ... defence".<sup>219</sup> From this allocation of the burden of proof, it is normally for the respondent, first, to *raise* the defence and, second, to *prove* that the challenged measure meets the requirements of the defence provision.

105. We are therefore of the view that the European Communities must *prove* that the Drug Arrangements satisfy the conditions set out in the Enabling Clause. Consistent with the principle of *jura novit curia*<sup>220</sup>, it is not the responsibility of the European Communities to provide us with the

<sup>216</sup>Panel Report, para. 7.53.

<sup>217</sup>*Ibid.*, para. 7.45.

<sup>218</sup>*Ibid.* (emphasis added)

<sup>219</sup>Appellate Body Report, p. 14, DSR 1997:1, at 335. (See also, Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 133; and Appellate Body Report, *India – Quantitative Restrictions*, para. 136)

<sup>220</sup>The principle of *jura novit curia* has been articulated by the International Court of Justice as follows:

It being the duty of the Court itself to ascertain and apply the relevant law in the given circumstances of the case, the burden of establishing or proving rules of international law cannot be imposed upon any of the parties, for the law lies within the judicial knowledge of the Court.

(International Court of Justice, Merits, *Case Concerning Military and Paramilitary Activities in and against Nicaragua (Nicaragua v. United States of America)*, 1986 ICJ Reports, p. 14, para. 29 (quoting International Court of Justice, Merits, *Fisheries Jurisdiction Case (United Kingdom of Great Britain and Northern Ireland v. Iceland)*, 1974 ICJ Reports, p. 9, para. 17))

legal interpretation to be given to a particular provision in the Enabling Clause<sup>221</sup>; instead, the burden of the European Communities is to adduce sufficient evidence to substantiate its assertion that the Drug Arrangements comply with the requirements of the Enabling Clause.

1. Responsibility for Raising the Enabling Clause

106. With respect to the legal responsibility for *raising* a defence as an issue in a dispute settlement proceeding, however, we regard the particular circumstances of this case as dictating a special approach, given the fundamental role of the Enabling Clause in the WTO system as well as its contents. The Enabling Clause authorizes developed-country Members to grant enhanced market access to products from developing countries beyond that granted to products from developed countries. Enhanced market access is intended to provide developing countries with increasing returns from their growing exports, which returns are critical for those countries' economic development. The Enabling Clause thus plays a vital role in promoting trade as a means of stimulating economic growth and development. In this respect, the Enabling Clause is not a typical "exception", or "defence", in the style of Article XX of the GATT 1994, or of other exception provisions identified by the Appellate Body in previous cases.

107. A brief review of the history of the Enabling Clause confirms its special status in the covered agreements. When the GATT 1947 entered into force, the Contracting Parties stated that one of its objectives was to "rais[e] standards of living".<sup>222</sup> However, this objective was to be achieved in countries at all stages of economic development through the *universally-applied* commitments embodied in the GATT provisions. In 1965, the Contracting Parties added Articles XXXVI, XXXVII, and XXXVIII to form Part IV of the GATT 1947, entitled "Trade and Development".<sup>223</sup> Article XXXVI expressly recognized the "need for positive efforts" and "individual and joint action" so that developing countries would be able to share in the growth in international trade and further their economic development.<sup>224</sup> Some of these "positive efforts" resulted in the Agreed Conclusions

<sup>222</sup>Compare Appellate Body Report, *EC – Hormones*, para. 156, which states:

[N]othing in the DSU limits the faculty of a panel freely to use arguments submitted by any of the parties -- or to develop its own legal reasoning -- to support its own findings and conclusions on the matter under its consideration. A panel might well be unable to carry out an objective assessment of the matter, as mandated by Article 11 of the DSU, if in its reasoning it had to restrict itself solely to arguments presented by the parties to the dispute.

<sup>223</sup>GATT 1947, Preamble, first recital.

<sup>224</sup>*Protocol Amending the General Agreement on Tariffs and Trade to Introduce a Part IV on Trade and Development*, BISD 13S/2 (1965).

<sup>225</sup>GATT 1947, Arts. XXXVI:3 and XXXVI:1(d).

of the United Nations Conference on Trade and Development ("UNCTAD") Special Committee on Preferences (the "Agreed Conclusions")<sup>225</sup>, which recognized that preferential tariff treatment accorded under a generalized scheme of preferences was key for developing countries "(a) to increase their export earnings; (b) to promote their industrialization; and (c) to accelerate their rates of economic growth."<sup>226</sup> The Agreed Conclusions also made clear that the achievement of these objectives through the adoption of preferences by developed countries required a GATT waiver, in particular, with respect to the MFN obligation in Article I.1.<sup>227</sup> Accordingly, the Contracting Parties adopted the 1971 Waiver Decision in order to waive the obligations of Article I of the GATT 1947 and thereby authorize the granting of tariff preferences to developing countries for a period of ten years.<sup>228</sup>

108. In 1979, the Enabling Clause expanded the authorization provided by the 1971 Waiver Decision to cover additional preferential measures and made the authorization a permanent feature of the GATT. In his report at the conclusion of the Tokyo Round of negotiations, the then-Director General observed:

The Enabling Clause meets a fundamental concern of developing countries by introducing differential and more favourable treatment as an integral part of the GATT system, no longer requiring waivers from the GATT. It also provides the perspective against which the participation of developing countries in the trading system may be seen.<sup>229</sup>

Members reaffirmed the significance of the Enabling Clause in 1994 with the incorporation of the Enabling Clause into the GATT 1994.<sup>230</sup> The relationship between trade and development, and in particular the role of the Enabling Clause, remain prominent on the agenda of the WTO, as recognized by the Doha Ministerial Conference in 2001.<sup>231</sup>

109. We thus understand that, between the entry into force of the GATT and the adoption of the Enabling Clause, the Contracting Parties determined that the MFN obligation failed to secure

<sup>225</sup>Attached as Annex D-4 to the Panel Report.

<sup>226</sup>Agreed Conclusions, para. I.2 (Panel Report, p. D-8).

<sup>227</sup>*Ibid.*, paras. IX.1 and IX.2(c) (Panel Report, pp. D-13-D-14).

<sup>228</sup>1971 Waiver Decision, para. (a) (Panel Report, p. D-4).

<sup>229</sup>European Communities' appellant's submission, para. 25 (quoting Report by the Director-General of GATT, in GATT, *The Tokyo Round of Multilateral Trade Negotiations* (1979), Vol. I, p. 99).

<sup>230</sup>Para. 1(b)(iv) of the language of Annex 1A to the *WTO Agreement* incorporating the GATT 1994 into the *WTO Agreement*.

<sup>231</sup>Ministerial Decision of 14 November 2001, *Implementation-related Issues and Concerns*, WT/MIN(01)/17, paras. 12.1-12.2.

adequate market access for developing countries so as to stimulate their economic development. Overcoming this required recognition by the multilateral trading system that certain obligations, applied to all Contracting Parties, could impede rather than facilitate the objective of ensuring that developing countries secure a share in the growth of world trade. This recognition came through an authorization for GSP schemes in the 1971 Waiver Decision and then in the broader authorization for preferential treatment for developing countries in the Enabling Clause.<sup>232</sup>

110. In our view, the special status of the Enabling Clause in the WTO system has particular implications for WTO dispute settlement. As we have explained, paragraph 1 of the Enabling Clause enhances market access for developing countries as a means of improving their economic development by authorizing preferential treatment for those countries, "notwithstanding" the obligations of Article I. It is evident that a Member cannot implement a measure authorized by the Enabling Clause without accord an "advantage" to a developing country's products over those of a developed country. It follows, therefore, that every measure undertaken pursuant to the Enabling Clause would necessarily be inconsistent with Article I, if assessed on that basis alone, but it would be exempted from compliance with Article I because it meets the requirements of the Enabling Clause. Under these circumstances, we are of the view that a complaining party challenging a measure taken pursuant to the Enabling Clause must allege more than mere inconsistency with Article I:1 of the GATT 1994, for to do only that would not convey the "legal basis of the complaint sufficient to present the problem clearly."<sup>233</sup> In other words, it is insufficient in WTO dispute settlement for a complainant to allege inconsistency with Article I:1 of the GATT 1994 if the complainant seeks also to argue that the measure is not justified under the Enabling Clause. This is especially so if the challenged measure, like that at issue here, is plainly taken pursuant to the Enabling Clause, as we discuss *infra*.<sup>234</sup>

111. Furthermore, the history and objective of the Enabling Clause lead us to agree with the European Communities<sup>235</sup> that Members are *encouraged* to deviate from Article I in the pursuit of "differential and more favourable treatment" for developing countries. This deviation, however, is encouraged only to the extent that it complies with the series of requirements set out in the Enabling

<sup>232</sup>We recognize that an exemption for developing countries from certain GATT obligations also resulted from the 1954-1955 Review Session, where the Contracting Parties amended the GATT by adding Article XVIII for the benefit of developing countries facing balance-of-payments difficulties or seeking to nurture an infant industry. (See Reports Relating to the Review of the Agreement: Quantitative Restrictions, GATT Document L/332/Rev.1 and Addenda, adopted 2, 4 and 5 March 1955, BISD, 3S/170, paras. 3, 35-36, 44, and 52)

<sup>233</sup>DSU, Art. 6.2. See also, Appellate Body Report, *Korea – Dairy*, paras. 120, 124, and 127.

<sup>234</sup>*Infra*, paras. 116-117.

<sup>235</sup>European Communities' appellant's submission, para. 53.

Clause, requirements that we find to be more extensive than more typical defences such as those found in Article XX.

112. Paragraph 2 of the Enabling Clause identifies the four types of measures to which the authorization of paragraph 1 applies:

- (a) Preferential tariff treatment accorded by developed contracting parties to products originating in developing countries in accordance with the Generalized System of Preferences;<sup>3</sup>
- (b) Differential and more favourable treatment with respect to the provisions of the General Agreement concerning non-tariff measures governed by the provisions of instruments multilaterally negotiated under the auspices of the GATT;
- (c) Regional or global arrangements entered into amongst less-developed contracting parties for the mutual reduction or elimination of tariffs and, in accordance with criteria or conditions which may be prescribed by the CONTRACTING PARTIES, for the mutual reduction or elimination of non-tariff measures, on products imported from one another
- (d) Special treatment of the least developed among the developing countries in the context of any general or specific measures in favour of developing countries.

<sup>3</sup> As described in the Decision of the CONTRACTING PARTIES of 25 June 1971, relating to the establishment of "generalized, non-reciprocal and non discriminatory preferences beneficial to the developing countries" (BISD 18S/24).

Measures that a Member claims are exempt from a finding of inconsistency with Article I by virtue of the Enabling Clause must fit within these sub-paragraphs, of which the most relevant for this case is paragraph 2(a), which provides for GSP schemes. As we discuss in greater detail *infra*<sup>236</sup>, this provision requires the preferential treatment to be "in accordance with" the GSP and further defines this obligation through each of the terms "generalized, non-reciprocal and non discriminatory". Paragraphs 2(b)-(d) impose different obligations to be satisfied by a Member taking a measure pursuant to those provisions. Paragraph 3 identifies three conditions that must also be satisfied by any measure under the Enabling Clause. Paragraph 4 sets forth procedural conditions for the introduction, modification, or withdrawal of a preferential measure for developing countries.

<sup>236</sup>*Infra*, paras. 142-174.

Paragraphs 5 through 9 include obligations that are not necessarily related to measures providing "differential and more favourable treatment".<sup>237</sup>

113. In the light of the extensive requirements set forth in the Enabling Clause, we are of the view that, when a complaining party considers that a preference scheme of another Member does not meet one or more of those requirements, the specific provisions of the Enabling Clause with which the scheme allegedly falls afoul, form critical components of the "legal basis of the complaint"<sup>238</sup> and, therefore, of the "matter" in dispute.<sup>239</sup> Accordingly, a complaining party cannot, in good faith, ignore those provisions and must, in its request for the establishment of a panel, identify them and thereby "notify" the parties and third parties of the nature of [its] case".<sup>240</sup> For the failure of such a complaining party to raise the relevant provisions of the Enabling Clause would place an unwarranted burden on the responding party. This due process consideration applies equally to the elaboration of a complaining party's case in its written submissions, which must "explicitly" articulate a claim so that the panel and all parties to a dispute "understand that a specific claim has been made, [are] aware of its dimensions, and have an adequate opportunity to address and respond to it".<sup>241</sup>

114. Exposing preference schemes to open-ended challenges would be inconsistent, in our view, with the intention of Members, as reflected in the Enabling Clause, to "encourage"<sup>242</sup> the adoption of preferential treatment for developing countries and to provide a practical means of doing so within the legal framework of the covered agreements. Accordingly, although a responding party must defend the consistency of its preference scheme with the conditions of the Enabling Clause and must prove such consistency, a *complaining* party has to define the parameters within which the *responding* party must make that defence.

<sup>237</sup> See Enabling Clause (attached as Annex 2 to this Report).

<sup>238</sup> DSU, Art. 6.2, which provides:

The request for the establishment of a panel shall be made in writing. It shall indicate whether consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly. In case the applicant requests the establishment of a panel with other than standard terms of reference, the written request shall include the proposed text of special terms of reference.

<sup>239</sup> Appellate Body Report, *US – Carbon Steel*, para. 125 (referring to Appellate Body Report, *Guatemala – Cement I*, paras. 69-76).

<sup>240</sup> *Ibid.*, para. 126 (referring to Appellate Body Report, *Brazil – Desiccated Coconut*, p. 22, DSR 1997-1, at 186; and Appellate Body Report, *EC – Bananas III*, para. 142).

<sup>241</sup> Appellate Body Report, *Chile – Price Band System*, para. 164.

<sup>242</sup> European Communities' appellant's submission, para. 53.

115. The responsibility of the complaining party in such an instance, however, should not be overstated. It is merely to *identify* those provisions of the Enabling Clause with which the scheme is allegedly inconsistent, without bearing the burden of *establishing* the facts necessary to support such inconsistency. That burden, as we concluded above<sup>243</sup>, remains on the responding party invoking the Enabling Clause as a defence.

116. We observe, moreover, that the measure challenged in this dispute is unmistakably a preferential tariff scheme, granted by a developed-country Member in favour of developing countries, and proclaiming to be in accordance with the GSP. The Drug Arrangements are found in Council Regulation (EC) No. 2501/2001, the title of which indicates the Regulation to be "applying a scheme of generalised tariff preferences for the period from 1 January 2002 to 31 December 2004". The first recital in the Preamble to the Regulation provides:

Since 1971, the Community has granted trade preferences to developing countries, in the framework of its scheme of generalised tariff preferences.

In its original proposal for the Regulation, the European Commission explained:

In 1994, the Commission adopted some guidelines on the *role of the GSP* for the ten-year period 1995 to 2004. A new regulation is required in order to implement *those guidelines* for the remainder of the period, i.e. the years 2002 to 2004. This memorandum is meant to explain the proposal for that new regulation.<sup>244</sup> (footnote omitted; emphasis added)

In its amended proposal, adding Pakistan to the list of beneficiaries under the Drug Arrangements, the European Commission further stated:

Since the *GSP drug regime* was extended to the countries of the Andean Community and to those of the Central American Common Market, it provided an important incentive to allow for the substitution of illicit crops, enhance exports in order to create jobs not linked to drug production and trafficking and foster diversification.

<sup>243</sup> *Supra*, para. 105.

<sup>244</sup> Explanatory Memorandum to the Proposal for a Council Regulation applying a scheme of generalised tariff preferences for the period 1 January 2002 to 31 December 2004, para. 1 (attached to Amended Proposal for a Council Regulation applying a scheme of generalised tariff preferences for the period 1 January 2002 to 31 December 2004, 2001/0131 (ACC), at p. 3) (Exhibit India-7 submitted by India to the Panel).

The problems which Pakistan is facing today, are similar. The *GSP drug regime* is therefore likely to stabilise its economic and social structures and thus consolidate the institutions that uphold the rule of law.<sup>245</sup> (emphasis added)

117. It is therefore clear, on the face of the Regulation and from official, publicly-available explanatory documentation, that the Drug Arrangements challenged by India in this dispute are part of a preferential tariff scheme implemented by the European Communities pursuant to the authorization in paragraph 2(a) of the Enabling Clause. As such, India would have been well aware that the Drug Arrangements must comply with the requirements of the Enabling Clause, and that the European Communities was likely to invoke the Enabling Clause in response to a challenge of inconsistency with Article I:1. Indeed, India admitted as much before the Panel.<sup>246</sup> India also must have believed that at least certain of those requirements were not being met and that, as a consequence, the inconsistency of the Drug Arrangements with Article I could not be justified. Accordingly, India, as the complaining party, should reasonably have articulated its claims of inconsistency with specific provisions of the Enabling Clause at the outset of this dispute as part of its responsibility to "engage in [dispute settlement] procedures in good faith in an effort to resolve the dispute".<sup>247</sup>

118. In sum, although the burden of *justifying* the Drug Arrangements under the Enabling Clause falls on the European Communities, India was required to do more than simply allege inconsistency with Article I. India's claim of inconsistency with Article I with respect to the measure challenged here is inextricably linked with its argument that the Drug Arrangements do not satisfy the conditions in the Enabling Clause and that, therefore, they cannot be justified as a derogation from Article I. In the light of the above considerations, we are of the view that India was required to (i) identify, in its

<sup>245</sup>Explanatory Memorandum to the Amended Proposal for a Council Regulation applying a scheme of generalised tariff preferences for the period 1 January 2002 to 31 December 2004, 2001/0131 (ACC), p. 2, fourth and fifth recitals (Exhibit India-7 submitted by India to the Panel).

<sup>246</sup>See, for example, India's first written submission to the Panel, para. 44, which states: "[S]ince the Drug Arrangements are part of the EC's GSP scheme, it may reasonably be assumed that the EC will invoke the Enabling Clause as a defence."

<sup>247</sup>DSU, Art. 3.10. See also, Appellate Body Report, *US – FSC*, para. 166, which reads:

Article 3.10 of the DSU commits Members of the WTO, if a dispute arises, to engage in dispute settlement procedures "in good faith in an effort to resolve the dispute". This is another specific manifestation of the principle of good faith which, we have pointed out, is at once a general principle of law and a principle of general international law. This pervasive principle requires both complaining and responding Members to comply with the requirements of the DSU (and related requirements in other covered agreements) in good faith. By good faith compliance, complaining Members accord to the responding Members the full measure of protection and opportunity to defend, contemplated by the letter and spirit of the procedural rules. (footnote omitted)

request for the establishment of a panel, which obligations in the Enabling Clause the Drug Arrangements are alleged to have contravened, and (ii) make written submissions in support of this allegation. The requirement to make such an argument, however, does not mean that India must prove inconsistency with a provision of the Enabling Clause, because the ultimate burden of establishing the consistency of the Drug Arrangements with the Enabling Clause lies with the European Communities.<sup>248</sup>

2. Whether India Raised the Enabling Clause Before the Panel

119. We turn now to examine whether, in fact, India fulfilled these requirements and thereby sufficiently identified the scope of its claim before the Panel. In its request for consultations, India claimed that the Drug Arrangements and the special incentive arrangements for the protection of labour rights and the environment "nullify or impair the benefits accruing to India under the most-favoured-nation provisions of Article I:1 of the GATT 1994 and paragraphs 2(a), 3(a) and 3(c) of the Enabling Clause."<sup>249</sup> In its request for the establishment of a panel, India asked that a panel examine whether the aforementioned arrangements of the European Communities' GSP scheme "are consistent with Article I:1 of the GATT 1994 and the requirements set out in paragraphs 2(a), 3(a) and 3(c) of the Enabling Clause".<sup>250</sup> The Panel's terms of reference, therefore, included India's allegations that certain aspects of the European Communities' GSP scheme were not "consistent" with, or did not "meet the requirements set out in", paragraphs 2(a), 3(a), and 3(c) of the Enabling Clause.<sup>251</sup>

<sup>248</sup>Compare Appellate Body Report, *US – Certain EC Products*, para. 114, which states:

On the basis of our review of the European Communities' submissions and statements to the Panel, we conclude that the European Communities *did not specifically claim* before the Panel that, by adopting the 3 March Measure, the United States acted inconsistently with Article 23.2(a) of the DSU. As the European Communities did not make a specific claim of inconsistency with Article 23.2(a), it *did not adduce any evidence or arguments* to demonstrate that the United States made a "determination as to the effect that a violation has occurred" in breach of Article 23.2(a) of the DSU. And, as the European Communities did not adduce any evidence or arguments in support of a claim of violation of Article 23.2(a) of the DSU, the European Communities could not have established, and *did not establish, a prima facie case* of violation of Article 23.2(a) of the DSU. (footnotes omitted; emphasis added)

<sup>249</sup>Request for consultations by India, WT/DS246/1, 12 March 2002, p. 1.

<sup>250</sup>Request for the establishment of a panel by India, WT/DS246/4, 9 December 2002, p. 2. In addition to the Drug Arrangements and the special incentives for the protection of labour rights and the environment, India also challenged the WTO-consistency of "any implementing rules and regulations, ... any amendments to any of the foregoing, and ... their application". (*Ibid*)

<sup>251</sup>Request for the establishment of a panel by India, WT/DS246/4, 9 December 2002, pp. 1-2. The Panel's terms of reference incorporated these allegations by reference to document WT/DS246/4. (Constitution of the panel established at the request of India, WT/DS246/5, 6 March 2003, para. 2)

120. In its written submissions before the Panel, India clearly invoked paragraph 2(a) of the Enabling Clause as the basis for its allegation that the Drug Arrangements are not "justified" by the Enabling Clause.<sup>252</sup> For example, in its first written submission before the Panel, India stated:

The tariff preferences under the Drug Arrangements are beneficial to some developing countries and detrimental to others and consequently do not comply with paragraph 2(a) of the Enabling Clause.<sup>253</sup>

121. India's second written submission before the Panel included a sub-heading entitled, "The EC has failed to demonstrate that under the Drug Arrangements it accords tariff treatment that is 'non-discriminatory' within the meaning of paragraph 2(a) of the Enabling Clause".<sup>254</sup> Under this sub-heading, India argued:

[P]aragraph 2(a) of the Enabling Clause was meant to ensure that benefits under the GSP are extended to *all* developing countries, as opposed to some developing countries. Paragraph 2(a) of the Enabling Clause does not envisage selectivity. Instead, it requires that preferential tariff treatment is accorded to all developing countries.<sup>255</sup> (original italics)

India further argued that, even if the European Communities' interpretation of paragraph 2(a) were correct, the Drug Arrangements would not be "non-discriminatory", as required by footnote 3 to paragraph 2(a).<sup>256</sup>

122. We find that India acted in good faith, in its written submissions before the Panel, explaining why, in its view, the Drug Arrangements fail to meet certain requirements of the Enabling Clause, namely, those present in paragraph 2(a). Such an explanation, in our view, was sufficient to place the European Communities on notice as to the reasons underlying India's allegation that the Drug Arrangements are not justified by the relevant provision of the Enabling Clause. With such notice,

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<sup>252</sup>India's first written submission to the Panel, heading IV.C. and para. 67; India's second written submission to the Panel, heading III.B. and para. 164. By the time of its first written submission to the Panel, India had indicated to the European Communities and to the Panel that this dispute was limited to the WTO-consistency of the Drug Arrangements, but that India reserved its right to challenge the special incentives for the protection of labour rights and the environment in a future dispute settlement proceeding. (See *supra*, para. 4; and Panel Report, para. 1.5) Both participants confirmed, in response to questioning at the oral hearing, that the measure at issue in this dispute was limited to the Drug Arrangements.

<sup>253</sup>India's first written submission to the Panel, para. 62.

<sup>254</sup>India's second written submission to the Panel, heading III.B.3.

<sup>255</sup>*Ibid.*, para. 95.

<sup>256</sup>*Ibid.*, paras. 119-128.

the European Communities could be expected to defend its challenged measure under the Enabling Clause, in relation to which the European Communities ultimately bears the burden of justification.

123. In allocating the burden of proof, therefore, we conclude that India was required to raise the Enabling Clause in making its claim of inconsistency with Article I:1. Once India had identified, in its panel request and through argumentation in its written submissions, the relevant obligations of the Enabling Clause that it claims were not satisfied by the Drug Arrangements, the European Communities was then required to prove that the Drug Arrangements met those obligations, having chosen to rely on the Enabling Clause as a defence.

124. Finally, we observe that the European Communities' appeal of the Panel's conclusion that the Drug Arrangements are inconsistent with Article I:1 of the GATT 1994 is "based on" the European Communities' claim that the Panel erroneously found that (i) the Enabling Clause is an "exception" to Article I:1; (ii) the Enabling Clause "does not exclude the applicability" of Article I:1; and (iii) the European Communities had the burden of proving the consistency of the Drug Arrangements with that Clause.<sup>257</sup> As we have not reversed any of these findings of the Panel<sup>258</sup>, we do not need to review further and we *do not rule* on the Panel's conclusion that the Drug Arrangements are inconsistent with Article I:1 of the GATT 1994.<sup>259</sup>

125. For these reasons, we *modify* the Panel's finding, in paragraph 7.53 of the Panel Report, that "the European Communities bears the burden of invoking the Enabling Clause and justifying its Drug Arrangements under that provision." We *find* that it was incumbent upon India to *raise* the Enabling Clause in making its claim of inconsistency with Article I:1 of the GATT 1994, but that the

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<sup>257</sup>In its Notice of Appeal, the European Communities' reference to Article I:1 was limited to its decision to:

- ... seek[] review of the Panel's legal conclusion that [the Drug Arrangements] are inconsistent with Article I:1 ... This conclusion is based on the following erroneous legal findings:
- that the Enabling Clause is an "exception" to Article I:1 of the GATT;
- that the Enabling Clause does not exclude the applicability of Article I:1 of the GATT;
- that the EC had the burden of proving that the Drug Arrangements were consistent with the Enabling Clause.

(Notification of an appeal by the European Communities, WT/DS246/7, 8 January 2004, p.1 (attached as Annex I to this Report))

<sup>258</sup>*Supra*, paras. 99, 103, and 123.

<sup>259</sup>Panel Report, paras. 7.60 and 8.1(b). The European Communities confirmed, in response to questioning at the oral hearing, that it is not appealing the Panel's conclusion, in paragraph 7.60 of the Panel Report, that the tariff advantages under the Drug Arrangements are inconsistent with Article I:1 because they are not accorded "unconditionally" to the like products originating in all other WTO Members.

European Communities bore the burden of *proving* that the Drug Arrangements satisfy the conditions of the Enabling Clause, in order to justify those Arrangements under that Clause. We *find*, further, that India sufficiently raised paragraph 2(a) of the Enabling Clause in making its claim of inconsistency with Article I:1 before the Panel. We turn now to examine whether the European Communities met its burden of justifying the Drug Arrangements under that provision.

**V. Whether the Drug Arrangements are Justified Under the Enabling Clause**

126. The European Communities "appeals subsidiarily" the Panel's finding that the Drug Arrangements are not justified under paragraph 2(a), should we "conclude that the Enabling Clause is an exception to GATT Article I:1, or that India made a valid claim under the Enabling Clause".<sup>260</sup> Having found that the Enabling Clause is in the nature of an exception to Article I:1 of the GATT 1994, we proceed to examine the European Communities' appeal as it relates to paragraph 2(a) of the Enabling Clause.

127. The European Communities challenges three of the Panel's findings, namely that:

- (a) "the term 'non-discriminatory' in footnote 3 [to paragraph 2(a) of the Enabling Clause] requires that identical tariff preferences under GSP schemes be provided to all developing countries without differentiation, except for the implementation of a priori limitations"<sup>261</sup>;
- (b) "the term 'developing countries' in paragraph 2(a) [of the Enabling Clause] should be interpreted to mean *all* developing countries, with the exception that where developed countries are implementing a priori limitations, 'developing countries' may mean *less than all* developing countries"<sup>262</sup>; and, ultimately, that
- (c) the European Communities failed "to demonstrate that the Drug Arrangements are justified under paragraph 2(a) of the Enabling Clause".<sup>263</sup>

<sup>260</sup>European Communities' appellant's submission, para. 67.

<sup>261</sup>Panel Report, paras. 7.161 and 7.176.

<sup>262</sup>*Ibid.*, para. 7.174. (original italics; footnote omitted)

<sup>263</sup>*Ibid.*, para. 8.1(d).

128. Before addressing these specific issues, we will identify the precise scope of the appeal before us. In doing so, we note that both the European Communities and India agree that, in addressing paragraph 2(a) of the Enabling Clause, the Panel implicitly made findings on issues that were not before it. Thus, India submits that "[t]he issue before the Panel was not whether the EC could exclude from its GSP scheme countries claiming developing country status."<sup>264</sup> In India's view, that issue did not arise "because India and all the countries enjoying tariff preferences under the Drug Arrangements are beneficiaries under the EC's GSP scheme."<sup>265</sup> Also not before the Panel, according to India, was "whether the EC's mechanisms for the graduation of developing countries meet the requirements of the Enabling Clause."<sup>266</sup> India emphasizes that it "did not submit any claims on these issues to the Panel because they are not relevant to the resolution of this dispute."<sup>267</sup> In other words, according to India, the legal issues raised in this dispute "relate exclusively"<sup>268</sup> to the treatment of those countries that a preference-granting country has included in its GSP scheme as beneficiaries. The European Communities echoes India's concern that the Panel read obligations into the Enabling Clause "in respect of issues which had not been raised by any of the parties and which [the Panel] did not have to address in order to resolve the dispute."<sup>269</sup>

129. Against this background, we understand India's claim before the Panel to have been limited to the consistency of the Drug Arrangements with the term "non-discriminatory" in footnote 3 to paragraph 2(a) of the Enabling Clause.<sup>270</sup> In particular, India's challenge to the Drug Arrangements is based on its submission that the term "non-discriminatory" prevents preference-granting countries from according preferential tariff treatment to any beneficiary of their GSP schemes without granting identical preferential tariff treatment to all other beneficiaries. Therefore, in this Report, we do not rule on whether the Enabling Clause permits *ab initio* exclusions from GSP schemes of countries claiming developing country status, or the partial or total withdrawal of GSP benefits from certain developing countries under certain conditions.

<sup>264</sup>India's appellee's submission, para. 101.

<sup>265</sup>*Ibid.*

<sup>266</sup>India's opening statement at the oral hearing. By "graduation", we understand India to refer to the withdrawal of preferential tariff treatment with respect to specific products or designated developing countries on grounds of the degree of their development.

<sup>267</sup>India's opening statement at the oral hearing.

<sup>268</sup>India's appellee's submission, para. 103.

<sup>269</sup>European Communities' appellant's submission, para. 7.

<sup>270</sup>See *supra*, paras. 120-122.

130. We note, moreover, that the European Communities has *not* appealed the Panel's interpretation of paragraph 3(c) of the Enabling Clause.<sup>271</sup> Instead, the European Communities has invoked that provision solely as "contextual support" for its interpretation of "non-discriminatory" in footnote 3.<sup>272</sup> We also note that the Panel made no findings in this case as to whether the Drug Arrangements are inconsistent with paragraph 3(a) or 3(c) of the Enabling Clause. Our mandate, pursuant to Article 17.6 of the DSU, is limited to "issues of law covered in the panel report and legal interpretations developed by the panel". Therefore, in this appeal, we are not required to, and we shall not address, the issue of whether the Drug Arrangements are consistent with paragraphs 3(a) and 3(c) of the Enabling Clause. This does not prevent us, of course, from examining those paragraphs as context for our interpretation of "non-discriminatory" in footnote 3.

131. With these considerations in mind, we turn to address the meaning of the term "non-discriminatory" in footnote 3. In doing so, we consider it useful to begin our analysis by setting out briefly the relevant findings of the Panel.

A. *Panel Findings*

132. The Panel stated at the outset that "[t]he main issue disputed by the parties is whether the Drug Arrangements are consistent with paragraph 2(a) of the Enabling Clause, particularly the requirement of 'non-discriminatory' in footnote 3 to this subparagraph."<sup>273</sup> Paragraph 2(a) reads:

2. The provisions of paragraph 1 apply to the following:

- (a) Preferential tariff treatment accorded by developed contracting parties to products originating in developing countries in accordance with the Generalized System of Preferences,<sup>3</sup>

<sup>3</sup> As described in the Decision of the CONTRACTING PARTIES of 25 June 1971, relating to the establishment of "generalized, non-reciprocal and non discriminatory preferences beneficial to the developing countries" (BISD 18S/24). (footnote 2 omitted)

<sup>271</sup>The European Communities refers to the Panel's finding, in paragraph 7.99 of the Panel Report, that paragraph 3(c) requires preference-granting countries to "provide product coverage and tariff cuts at levels in general no less than those offered and accepted in the Agreed Conclusions." The European Communities explains that "[s]ince this issue was not raised by India and is not directly relevant to the issues in dispute, ... the EC has not deemed [it necessary] to appeal it." (European Communities' appellant's submission, footnote 40 to para. 47)

<sup>272</sup>European Communities' appellant's submission, para. 126.

<sup>273</sup>Panel Report, para. 7.65.

133. The Panel went on to examine, not the language of those provisions, but the meaning of paragraph 3(c) of the Enabling Clause, which reads:

3. Any differential and more favourable treatment provided under this clause:

...

- (c) shall in the case of such treatment accorded by developed contracting parties to developing countries be designed and, if necessary, modified, to respond positively to the development, financial and trade needs of developing countries.

The Panel explained that "[i]t is only possible to give a full meaning to paragraph 2(a) and footnote 3 after determining whether paragraph 3(c) allows differentiation among developing countries in 'respond[ing] positively to the development, financial and trade needs of developing countries'."<sup>274</sup>

134. Having found that the text of paragraph 3(c) "does not reveal whether the 'needs of developing countries' refers to the needs of *all* developing countries or to the needs of *individual* developing countries"<sup>275</sup>, the Panel proceeded to examine "the drafting history in UNCTAD ... to identify the intention of the drafters on issues relating to the GSP arrangements."<sup>276</sup> The Panel concluded that paragraph 3(c) allows for differentiation among beneficiaries for the purposes of granting preferential treatment to least-developed countries and setting *a priori* import limitations for products originating in particularly competitive developing countries. The Panel asserted that "[n]o other differentiation among developing countries is permitted by paragraph 3(c)."<sup>277</sup>

135. Having made these findings based on its review of what it considered the "context" and "preparatory work"<sup>278</sup> of paragraph 3(c) of the Enabling Clause, the Panel turned to examine paragraph 2(a) and footnote 3 thereto. The Panel observed that the word "discriminate ... can have either a *neutral* meaning of making a distinction or a *negative* meaning carrying the connotation of a distinction that is unjust or prejudicial."<sup>279</sup> In order to determine the appropriate meaning of the

<sup>274</sup>Panel Report, para. 7.65 (quoting Enabling Clause, para. 3(c) (attached as Annex 2 to this Report)). In a footnote, the Panel explained further that "[t]he European Communities argue[d] that 'if the term 'non-discriminatory' was interpreted as prohibiting any difference in treatment between developing countries, developed countries would be effectively precluded from responding positively to those needs, thus rendering [to] a nullity the requirement set forth in paragraph 3(c)'" (*Ibid.*, footnote 291 to para. 7.65 (quoting European Communities' first written submission to the Panel, para. 711))

<sup>275</sup>*Ibid.*, para. 7.78. (original italics)

<sup>276</sup>*Ibid.*, para. 7.80.

<sup>277</sup>*Ibid.*, para. 7.116.

<sup>278</sup>*Ibid.*, para. 7.88.

<sup>279</sup>*Ibid.*, para. 7.126. (original italics)

term "non-discriminatory" as used in footnote 3, the Panel turned to the context of that term. According to the Panel, this context includes paragraphs 2(a), 2(d), and 3(c) of the Enabling Clause, with the "most relevant elements of context" being Resolution 21(II) of the Second Session of UNCTAD ("Resolution 21(II)")<sup>280</sup> and the Agreed Conclusions.<sup>281</sup> Based on its review of these documents, the Panel found that:

... the clear intention of the negotiators was to provide GSP equally to all developing countries and to eliminate all differentiation in preferential treatment to developing countries, with the exception of the implementation of a priori limitations in GSP schemes.<sup>282</sup>

136. The Panel concluded:

... that the requirement of non-discrimination, as a general principle formally set out in Resolution 21(II) and later carried over into the 1971 Waiver Decision and then into the Enabling Clause, obliges preference-giving countries to provide the GSP benefits to *all* developing countries without differentiation, except for the implementation of a priori limitations in GSP schemes.<sup>283</sup> (original italics)

137. The Panel found further support for its conclusion in its previous analysis of paragraph 3(c)<sup>284</sup> and in paragraph 2(d) of the Enabling Clause, which provides:

2. The provisions of paragraph 1 apply to the following:

(d) Special treatment of the least developed among the developing countries in the context of any general or specific measures in favour of developing countries. (footnote omitted)

The Panel stated that the term "non-discriminatory" cannot be interpreted "to permit preferential treatment to less than all developing countries without an explicit authorization".<sup>285</sup> According to the Panel, "[s]uch explicit authorization is only provided for the benefit of the least-developed countries

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<sup>280</sup>Resolution 21(II) of the Second Session of UNCTAD, entitled "Expansion and Diversification of Exports of Manufactures and Semi-Manufactures of Developing Countries" (attached as Annex D-3 to the Panel Report).

<sup>281</sup>Panel Report, para. 7.128.

<sup>282</sup>*Ibid.*, para. 7.144.

<sup>283</sup>*Ibid.*

<sup>284</sup>*Ibid.*, paras. 7.148-7.149.

<sup>285</sup>*Ibid.*, para. 7.151.

in paragraph 2(d) of the Enabling Clause and for the implementation of a priori limitations, as set out in the Agreed Conclusions."<sup>286</sup>

138. Turning to the "object and purpose" of the Enabling Clause, the Panel considered that "the objective of promoting the trade of developing countries and that of promoting trade liberalization generally"<sup>287</sup> are relevant for the interpretation of the term "non-discriminatory". The Panel determined, however, that the latter "contributes more to guiding the interpretation of 'non-discriminatory', given its function of preventing abuse in providing GSP."<sup>288</sup>

139. The Panel found further support for its interpretation in an examination of the "overall practice" of preference-granting countries<sup>289</sup>, which, according to the Panel, "suggests that there was a common understanding of 'equal' treatment to all developing countries except for a priori measures, and that it was on this basis that the 1971 Waiver Decision was adopted."<sup>290</sup>

140. Based on its analysis described above, the Panel found that:

... the term "non-discriminatory" in footnote 3 requires that *identical* tariff preferences under GSP schemes be provided to *all* developing countries without differentiation, except for the implementation of a priori limitations.<sup>291</sup> (emphasis added)

141. Regarding the measure at issue in this dispute, the Panel found that:

... the European Communities' Drug Arrangements, as a GSP scheme, do not provide identical tariff preferences to *all* developing countries and that the differentiation is neither for the purpose of special treatment to the least-developed countries, nor in the context of the implementation of a priori measures. Such differentiation is inconsistent with paragraph 2(a), particularly the term "non-discriminatory" in footnote 3[.]<sup>292</sup> (original italics)

Consequently, the Panel also found that "the European Communities has failed to demonstrate that the Drug Arrangements are justified under paragraph 2(a) of the Enabling Clause".<sup>293</sup>

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<sup>286</sup>Panel Report, para. 7.151.

<sup>287</sup>*Ibid.*, para. 7.158.

<sup>288</sup>*Ibid.*

<sup>289</sup>*Ibid.*, para. 7.159.

<sup>290</sup>*Ibid.*

<sup>291</sup>*Ibid.*, para. 7.161.

<sup>292</sup>*Ibid.*, para. 7.177.

<sup>293</sup>*Ibid.*, para. 8.1(d).

B. *Interpretation of the Term "Non-Discriminatory" in Footnote 3 to Paragraph 2(a) of the Enabling Clause*

142. We proceed to interpret the term "non-discriminatory" as it appears in footnote 3 to paragraph 2(a) of the Enabling Clause.

143. We recall first that the Enabling Clause has become a part of the GATT 1994.<sup>294</sup> Paragraph 1 of the Enabling Clause authorizes WTO Members to provide "differential and more favourable treatment to developing countries, without according such treatment to other WTO Members". As explained above, such differential treatment is permitted "notwithstanding" the provisions of Article I of the GATT 1994. Paragraph 2(a) and footnote 3 thereto clarify that paragraph 1 applies to "[p]referential tariff treatment accorded by developed contracting parties to products originating in developing countries in accordance with the Generalized System of Preferences"<sup>295</sup>, "[a]s described in the [1971 Waiver Decision], relating to the establishment of 'generalized, non-reciprocal and non-discriminatory preferences beneficial to the developing countries'".<sup>296</sup>

144. The Preamble to the 1971 Waiver Decision in turn refers to "preferential tariff treatment" in the following terms:

*Recalling that at the Second UNCTAD, unanimous agreement was reached in favour of the early establishment of a mutually acceptable system of generalized, non-reciprocal and non-discriminatory preferences beneficial to the developing countries in order to increase the export earnings, to promote the industrialization, and to accelerate the rates of economic growth of these countries;*

*Considering that mutually acceptable arrangements have been drawn up in the UNCTAD concerning the establishment of generalized, non-discriminatory, non-reciprocal preferential tariff treatment in the markets of developed countries for products originating in developing countries;*<sup>297</sup> (original italics; underlining added)

145. Paragraph 2(a) of the Enabling Clause provides, therefore, that, to be justified under that provision, preferential tariff treatment must be "in accordance" with the GSP "as described" in the *Preamble* to the 1971 Waiver Decision. "Accordance" being defined in the dictionary as

<sup>294</sup>See *supra*, footnote 192.

<sup>295</sup>Enabling Clause, para. 2(a) (attached as Annex 2 to this Report).

<sup>296</sup>*Ibid.*, footnote 3 to para. 2(a).

<sup>297</sup>1971 Waiver Decision, third and fourth recitals.

"conformity"<sup>298</sup>, only preferential tariff treatment that is in conformity with the description "generalized, non-reciprocal and non-discriminatory" treatment can be justified under paragraph 2(a).

146. In the light of the above, we do not agree with European Communities' assertion<sup>299</sup> that the Panel's interpretation of the word "non-discriminatory" in footnote 3 of the Enabling Clause is erroneous because the phrase "generalized, non-reciprocal and non-discriminatory" in footnote 3 merely refers to the description of the GSP in the 1971 Waiver Decision and, of itself, does not impose any legal obligation on preference-granting countries. Nor do we agree with the United States that the Panel erred in "assum[ing]" that the term "non-discriminatory" in footnote 3 imposes obligations on preference-granting countries, and that, instead, footnote 3 "is simply a cross-reference to where the Generalized System of Preferences is described."<sup>300</sup>

147. We find support for our interpretation in the French version of paragraph 2(a) of the Enabling Clause, requiring that the tariff preferences be accorded "*conformément au Système généralisé de préférences*". The term "in accordance" is thus "*conformément*" in the French version. In addition, the phrase "[a]s described in [the 1971 Waiver Decision]" in footnote 3 is stated as "*[l]el qu'il est défini dans la décision des PARTIES CONTRACTANTES en date du 25 juin 1971*". Similarly, the Spanish version uses the terms "*conformidad*" and "*[l]al como lo define la Decisión de las PARTES CONTRATANTES de 25 de junio de 1971*". In our view, the stronger, more obligatory language in both the French and Spanish texts—that is, using "as defined in" rather than "as described in"—lends support to our view that only preferential tariff treatment that is "generalized, non-reciprocal and non-discriminatory" is covered under paragraph 2(a) of the Enabling Clause.<sup>301</sup>

148. Having found that the qualification of the GSP as "generalized, non-reciprocal and non-discriminatory" imposes obligations that must be fulfilled for preferential tariff treatment to be justified under paragraph 2(a), we turn to address the Panel's finding that:

<sup>298</sup>*Shorter Oxford English Dictionary*, 5th ed., W.R. Trumble, A. Stevenson (eds.) (Oxford University Press, 2002), Vol. 1, p. 15.

<sup>299</sup>European Communities' response to questioning at the oral hearing.

<sup>300</sup>United States' third participant's submission, para. 11.

<sup>301</sup>We further note the existence of a 1999 WTO waiver allowing *developing* countries to grant special preferences to *least-developed* countries. (Waiver Decision on Preferential Tariff Treatment for Least-Developed Countries, WT/L/304, 15 June 1999 (the "1999 LDC Waiver")) That waiver applies only to "preferential tariff treatment ... provided on a generalized, non-reciprocal and non-discriminatory basis." (*Ibid.*, para. 2) As such, for tariff preferences to be justified thereunder, there is a *requirement* that the treatment be accorded on a "generalized, non-reciprocal and non-discriminatory basis." (emphasis added) We see no reason why *developed* countries would be permitted to provide preferential tariff treatment to developing countries under the Enabling Clause other than on a "non-discriminatory basis", when there is clearly a requirement for *developing* countries to provide such treatment to least-developed countries on a "non-discriminatory basis" under the 1999 LDC Waiver.

... the term "non-discriminatory" in footnote 3 requires that *identical* tariff preferences under GSP schemes be provided to *all* developing countries without differentiation, except for the implementation of a priori limitations.<sup>302</sup> (emphasis added)

149. The European Communities maintains that "non-discrimination" is not synonymous with formally equal treatment<sup>303</sup> and that "[t]reating differently situations which are objectively different is not discriminatory."<sup>304</sup> The European Communities asserts that "[t]he objective of the Enabling Clause is different from that of Article I:1 of the GATT."<sup>305</sup> In its view, the latter is concerned with "providing equal conditions of competition for imports of like products originating in all Members", whereas "the Enabling Clause is a form of Special and Differential Treatment for developing countries, which seeks the opposite result: to create unequal competitive opportunities in order to respond to the special needs of developing countries."<sup>306</sup> The European Communities derives contextual support from paragraph 3(c), which states that the treatment provided under the Enabling Clause "shall ... be designed and, if necessary, modified, to respond positively to the development, financial and trade needs of developing countries." The European Communities concludes that the term "non-discriminatory" in footnote 3 "does not prevent the preference-giving countries from differentiating between developing countries which have different development needs, where tariff differentiation constitutes an adequate response to such differences."<sup>307</sup>

150. India, in contrast, asserts that "non-discrimination in respect of tariff measures refers to formally equal[] treatment"<sup>308</sup> and that paragraph 2(a) of the Enabling Clause requires that "preferential tariff treatment [be] applied equally" among developing countries.<sup>309</sup> In support of its argument, India submits that an interpretation of paragraph 2(a) of the Enabling Clause that authorizes developed countries to provide "discriminatory tariff treatment *in favour of the developing countries* but not *between the developing countries* gives full effect to both Article I of the GATT and paragraph 2(a) of the Enabling Clause and minimises the conflict between them."<sup>310</sup> India emphasizes that, by consenting to the adoption of the Enabling Clause, developing countries did not

<sup>302</sup>Panel Report, para. 7.161.

<sup>303</sup>European Communities' appellant's submission, para. 71.

<sup>304</sup>*Ibid.*

<sup>305</sup>*Ibid.*, para. 152.

<sup>306</sup>*Ibid.*

<sup>307</sup>*Ibid.*, para. 188.

<sup>308</sup>India's appellee's submission, para. 120.

<sup>309</sup>*Ibid.*, para. 106.

<sup>310</sup>*Ibid.*, para. 92. (original italics)

"relinquish[] their MFN rights [under Article I of the GATT 1994] as between themselves, thus permitting developed countries to discriminate between them."<sup>311</sup>

151. We examine now the ordinary meaning of the term "non-discriminatory" in footnote 3 to paragraph 2(a) of the Enabling Clause. As we observed, footnote 3 requires that GSP schemes under the Enabling Clause be "generalized, non-reciprocal and non discriminatory". Before the Panel, the participants offered competing definitions of the word "discriminate". India suggested that this word means "to make or constitute a difference in or between; distinguish' and 'to make a distinction in the treatment of different categories of peoples or things'.<sup>312</sup> The European Communities, however, understood this word to mean "to make a distinction in the treatment of different categories of people or things, esp. *unjustly* or *prejudicially* against people on grounds of race, colour, sex, social status, age, etc."<sup>313</sup>

152. Both definitions can be considered as reflecting ordinary meanings of the term "discriminate"<sup>314</sup> and essentially exhaust the relevant ordinary meanings. The principal distinction between these definitions, as the Panel noted, is that India's conveys a "*neutral*" meaning of making a distinction", whereas the European Communities' conveys a "*negative*" meaning carrying the connotation of a distinction that is unjust or prejudicial."<sup>315</sup> Accordingly, the ordinary meanings of "discriminate" point in conflicting directions with respect to the propriety of according differential treatment. Under India's reading, any differential treatment of GSP beneficiaries would be prohibited, because such treatment necessarily makes a distinction between beneficiaries. In contrast, under the European Communities' reading, differential treatment of GSP beneficiaries would not be prohibited *per se*. Rather, distinctions would be impermissible only where the basis for such distinctions was improper. Given these divergent meanings, we do not regard the term "non-discriminatory", on its own, as determinative of the permissibility of a preference-granting country according different tariff preferences to different beneficiaries of its GSP scheme.

153. Nevertheless, at this stage of our analysis, we are able to discern some of the content of the "non-discrimination" obligation based on the ordinary meanings of that term. Whether the drawing of

<sup>311</sup>India's appellee's submission, para. 104.

<sup>312</sup>Panel Report, para. 7.126 (quoting *The New Shorter Oxford English Dictionary*, L. Brown (ed.) (Clarendon Press, 1993), Vol. 1, p. 689).

<sup>313</sup>*Ibid.* (quoting *The New Shorter Oxford English Dictionary*, L. Brown (ed.) (Clarendon Press, 1993), Vol. 1, p. 689) (italics added by the Panel)

<sup>314</sup>See *Shorter Oxford English Dictionary*, 5th ed., W.R. Trumble, A. Stevenson (eds.) (Oxford University Press, 2002), Vol. 1, p. 697.

<sup>315</sup>Panel Report, para. 7.126. (original italics)

distinctions is *per se* discriminatory, or whether it is discriminatory only if done on an improper basis, the ordinary meanings of "discriminate" converge in one important respect: they both suggest that distinguishing among similarly-situated beneficiaries is discriminatory. For example, India suggests that all beneficiaries of a particular Member's GSP scheme are similarly-situated, implicitly arguing that any differential treatment of such beneficiaries constitutes discrimination. The European Communities, however, appears to regard GSP beneficiaries as similarly-situated when they have "similar development needs".<sup>316</sup> Although the European Communities acknowledges that differentiating between similarly-situated GSP beneficiaries would be inconsistent with footnote 3 of the Enabling Clause, it submits that there is no inconsistency in differentiating between GSP beneficiaries with "different development needs".<sup>317</sup> Thus, based on the ordinary meanings of "discriminate", India and the European Communities effectively appear to agree that, pursuant to the term "non-discriminatory" in footnote 3, similarly-situated GSP beneficiaries should not be treated differently.<sup>318</sup> The participants disagree only as to the basis for determining whether beneficiaries are similarly-situated.

154. Paragraph 2(a), on its face, does not explicitly authorize or prohibit the granting of different tariff preferences to different GSP beneficiaries. It is clear from the ordinary meanings of "non-discriminatory", however, that preference-granting countries must make available identical tariff preferences to all similarly-situated beneficiaries.

155. We continue our interpretive analysis by turning to the immediate context of the term "non-discriminatory". We note first that footnote 3 to paragraph 2(a) stipulates that, in addition to being "non-discriminatory", tariff preferences provided under GSP schemes must be "generalized".

<sup>316</sup>European Communities' appellant's submission, para. 175. (See also, *ibid.*, para. 186)

<sup>317</sup>*Ibid.*, para. 188.

<sup>318</sup>We note that the contrasting definitions proffered by the participants, as well as the convergence of those definitions on the fact that similarly-situated entities should not be treated differently, find reflection in the use of the term "discrimination" in general international law. In this respect, we note, as an example, the definitions of "discrimination" provided by the European Communities, in footnotes 56 and 57 of its appellant's submission:

<sup>56</sup> ... Mere differences of treatment do not necessarily constitute discrimination ... discrimination may in general be said to arise where those who are in all material respects the same are treated differently, or where those who are in material respects different are treated in the same way.

(quoting R. Jennings and A. Watts (eds.), *Oppenheim's International Law*, 9th ed. (Longman, 1992), Vol. I, p. 378)

<sup>57</sup> ... Discrimination occurs when in a legal system an inequality is introduced in the enjoyment of a certain right, or in a duty, while there is no sufficient connection between the inequality upon which the legal inequality is based, and the right or the duty in which this inequality is made.

(quoting E.W. Vierdag, *The Concept of Discrimination in International Law*, (Martinus Nijhoff, 1973), p. 61)

According to the ordinary meaning of that term, tariff preferences provided under GSP schemes must be "generalized" in the sense that they "apply more generally; [or] become extended in application".<sup>319</sup> However, this ordinary meaning alone may not reflect the entire significance of the word "generalized" in the context of footnote 3 of the Enabling Clause, particularly because that word resulted from lengthy negotiations leading to the GSP. In this regard, we note the Panel's finding that, by requiring tariff preferences under the GSP to be "generalized", developed and developing countries together sought to eliminate existing "special" preferences that were granted only to certain designated developing countries.<sup>320</sup> Similarly, in response to our questioning at the oral hearing, the participants agreed that one of the objectives of the 1971 Waiver Decision and the Enabling Clause was to eliminate the fragmented system of special preferences<sup>321</sup> that were, in general, based on historical and political ties between developed countries and their former colonies.

156. It does not necessarily follow, however, that "non-discriminatory" should be interpreted to require that preference-granting countries provide "identical" tariff preferences under GSP schemes to "all" developing countries. In concluding otherwise, the Panel assumed that allowing tariff preferences such as the Drug Arrangements would necessarily "result [in] the collapse of the whole GSP system and a return back to special preferences favouring selected developing countries".<sup>322</sup> To us, this conclusion is unwarranted. We observe that the term "generalized" requires that the GSP schemes of preference-granting countries remain generally applicable.<sup>323</sup> Moreover, unlike the Panel, we believe that the Enabling Clause sets out sufficient conditions on the granting of preferences to protect against such an outcome. As we discuss below<sup>324</sup>, provisions such as paragraphs 3(a) and

<sup>319</sup>*Shorter Oxford English Dictionary*, 5th ed., W.R. Trumble, A. Stevenson (eds.) (Oxford University Press, 2002), Vol. 1, p. 1082.

<sup>320</sup>Panel Report, paras. 7.135-7.137. The Panel also observed that statements by developed and developing countries indicated the aim of providing GSP schemes with a broad scope, encompassing the granting of preferences by all developed countries to all developing countries. (*Ibid.*, paras. 7.131-7.132)

<sup>321</sup>See also European Communities' appellant's submission, para. 175.

<sup>322</sup>Panel Report, para. 7.102.

<sup>323</sup>The European Communities argues in this respect that the GATT Contracting Parties and the WTO Members have granted a number of waivers, as mentioned in the Panel Report, for tariff preferences that are "confined *ab initio* and permanently to a limited number of developing countries located in a certain geographical region". (European Communities' appellant's submission, paras. 184-185 (referring to Panel Report, para. 7.160)). See also, Panel Report, footnote 31 to para. 4.32 (referring to Waiver Decision on the Caribbean Basin Economic Recovery Act, GATT Document L/5779, 15 February 1985, BISD 31S/20, renewed 15 November 1995, WT/L/104; Waiver Decision on CARIBCAN, GATT Document L/6102, 28 November 1986, BISD 33S/97, renewed 14 October 1996, WT/L/185; Waiver Decision on the United States – Andean Trade Preference Act, GATT Document L/6991, 19 March 1992, BISD 39S/385, renewed 14 October 1996, WT/L/184; Waiver Decision on The Fourth ACP-EEC Convention of Lomé, GATT Document L/7604, 9 December 1994, BISD 41S/26, renewed 14 October 1996, WT/L/186; and Waiver Decision on European Communities – The ACP-EC Partnership Agreement, WT/MIN (01)/15), 14 November 2001.

<sup>324</sup>*Id.*, paras. 157-168.

3(c) of the Enabling Clause impose specific conditions on the granting of different tariff preferences among GSP beneficiaries.

157. As further context for the term "non-discriminatory" in footnote 3, we turn next to paragraph 3(c) of the Enabling Clause, which specifies that "differential and more favourable treatment" provided under the Enabling Clause:

... shall in the case of such treatment accorded by developed contracting parties to developing countries be designed and, if necessary, modified, to respond positively to the development, financial and trade needs of developing countries.

158. At the outset, we note that the use of the word "shall" in paragraph 3(c) suggests that paragraph 3(c) sets out an obligation for developed-country Members in providing preferential treatment under a GSP scheme to "respond positively" to the "needs of developing countries".<sup>325</sup> Having said this, we turn to consider whether the "development, financial and trade needs of developing countries" to which preference-granting countries are required to respond when granting preferences must be understood to cover the "needs" of developing countries *collectively*.

159. The Panel found that "the only appropriate way [under paragraph 3(c) of the Enabling Clause] of responding to the differing development needs of developing countries is for preference-giving countries to ensure that their [GSP] schemes have sufficient breadth of product coverage and depth of tariff cuts to respond positively to those differing needs."<sup>326</sup> In reaching this conclusion, the Panel appears to have placed a great deal of significance on the fact that paragraph 3(c) does not refer to needs of "*individual*" developing countries.<sup>327</sup> The Panel thus understood that paragraph 3(c) does not permit the granting of preferential tariff treatment exclusively to a sub-category of developing countries on the basis of needs that are common to or shared by only those developing countries. We see no basis for such a conclusion in the text of paragraph 3(c). Paragraph 3(c) refers generally to "the development, financial and trade needs of developing countries". The absence of an explicit requirement in the text of paragraph 3(c)<sup>328</sup> to respond to the needs of "all" developing countries, or

<sup>325</sup>We note that the European Communities agreed before the Panel that paragraph 3(c) of the Enabling Clause sets forth a "requirement". (European Communities' first written submission to the Panel, paras. 71 and 149)

<sup>326</sup>Panel Report, para. 7.149. (See also, *ibid.*, paras. 7.95-7.97 and 7.105)

<sup>327</sup>*Ibid.*, para. 7.78.

<sup>328</sup>The United States refers to Article 3.2 of the DSU to support its argument that "panels are barred from reading legal obligations into the Enabling Clause that are not found in the text." (United States' third participant's submission, para. 13)

to the needs of "each and every"<sup>329</sup> developing country, suggests to us that, in fact, that provision imposes no such obligation.<sup>330</sup>

160. Furthermore, as we understand it, the participants in this case agree that developing countries may have "development, financial and trade needs" that are subject to change and that certain development needs may be common to only a certain number of developing countries.<sup>331</sup> We see no reason to disagree. Indeed, paragraph 3(c) contemplates that "differential and more favourable treatment"<sup>332</sup> accorded by developed to developing countries may need to be "modified" in order to "respond positively" to the needs of developing countries. Paragraph 7 of the Enabling Clause supports this view by recording the expectation of "less-developed contracting parties" that their capacity to make contributions or concessions under the GATT will "improve with the progressive development of their economies and improvement in their trade situation". Moreover, the very purpose of the special and differential treatment permitted under the Enabling Clause is to foster economic development of developing countries. It is simply unrealistic to assume that such development will be in lockstep for all developing countries at once, now and for the future.

161. In addition, the Preamble to the *WTO Agreement*, which informs all the covered agreements including the GATT 1994 (and, hence, the Enabling Clause), explicitly recognizes the "need for positive efforts designed to ensure that developing countries, and especially the least developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development".<sup>333</sup> The word "commensurate" in this phrase appears to leave open the possibility that developing countries may have different needs according to their levels of development and particular circumstances. The Preamble to the *WTO Agreement* further recognizes

<sup>329</sup>Panel Report, para. 7.105. (italics omitted)

<sup>330</sup>In this respect, we agree with the European Communities that paragraph 3(c) should "be interpreted in a manner which, while preserving its relevance, is both workable for developed countries and consistent with the requirements that the preferences be *non-discriminatory*." (European Communities' appellant's submission, para. 138 (original italics))

<sup>331</sup>The European Communities emphasized before the Panel that the "development, financial and trade needs of developing countries" referred to in paragraph 3(c) of the Enabling Clause "[o]bviously ... may vary between different categories of developing countries, as well as over time." (European Communities' first written submission to the Panel, para. 71) That "needs of developing countries" may change over time was also acknowledged by India in response to our questioning at the oral hearing. In addition, we understand India not to disagree that developing countries may have different individual needs, given that it argues that paragraph 3(c) should be interpreted as requiring "GSP schemes [to] respond to the needs of developing countries as a whole and not their individual needs." (India's appellee's submission, para. 124)

<sup>332</sup>Enabling Clause, para. 1 (attached as Annex 2 to this Report).

<sup>333</sup>*WTO Agreement*, Preamble, second recital.

that Members' "respective needs and concerns at different levels of economic development"<sup>334</sup> may vary according to the different stages of development of different Members.

162. In sum, we read paragraph 3(c) as authorizing preference-granting countries to "respond positively" to "needs" that are *not* necessarily common or shared by all developing countries. Responding to the "needs of developing countries" may thus entail treating different developing-country beneficiaries differently.

163. However, paragraph 3(c) does not authorize *any* kind of response to *any* claimed need of developing countries. First, we observe that the types of needs to which a response is envisaged are limited to "development, financial and trade needs". In our view, a "need" cannot be characterized as one of the specified "needs of developing countries" in the sense of paragraph 3(c) based merely on an assertion to that effect by, for instance, a preference-granting country or a beneficiary country. Rather, when a claim of inconsistency with paragraph 3(c) is made, the existence of a "development, financial [or] trade need" must be assessed according to an *objective* standard. Broad-based recognition of a particular need, set out in the *WTO Agreement* or in multilateral instruments adopted by international organizations, could serve as such a standard.<sup>335</sup>

164. Secondly, paragraph 3(c) mandates that the response provided to the needs of developing countries be "positive". "Positive" is defined as "consisting in or characterized by constructive action or attitudes".<sup>336</sup> This suggests that the response of a preference-granting country must be taken with a view to *improving* the development, financial or trade situation of a beneficiary country, based on the particular need at issue. As such, in our view, the expectation that developed countries will "respond positively" to the "needs of developing countries" suggests that a sufficient nexus should exist between, on the one hand, the preferential treatment provided under the respective measure authorized by paragraph 2, and, on the other hand, the likelihood of alleviating the relevant "development, financial [or] trade need". In the context of a GSP scheme, the particular need at issue must, by its nature, be such that it can be effectively addressed through tariff preferences. Therefore, only if a preference-granting country acts in the "positive" manner suggested, in "respon[se]" to a

<sup>334</sup> *WTO Agreement*, Preamble, first recital.

<sup>335</sup> The European Communities argues that tariff preferences are an appropriate response to the drug problem. In support of its argument, the European Communities refers to the Preamble to the *Agreement on Agriculture* and the waiver for the United States' Andean Trade Preference Act. In addition, the European Communities finds support in several international conventions and resolutions that have recognized drug production and drug trafficking as entailing particular problems for developing countries. (See Panel Report, paras. 4.71-4.74; and European Communities' appellant's submission, paras. 144-149)

<sup>336</sup> *Shorter Oxford English Dictionary*, 5th ed., W.R. Trumble, A. Stevenson (eds.) (Oxford University Press, 2002), Vol. 2, p. 2293.

widely-recognized "development, financial [or] trade need", can such action satisfy the requirements of paragraph 3(c).

165. Accordingly, we are of the view that, by requiring developed countries to "respond positively" to the "needs of developing countries", which are varied and not homogeneous, paragraph 3(c) indicates that a GSP scheme may be "non-discriminatory" even if "identical" tariff treatment is not accorded to "all" GSP beneficiaries. Moreover, paragraph 3(c) suggests that tariff preferences under GSP schemes may be "non-discriminatory" when the relevant tariff preferences are addressed to a particular "development, financial [or] trade need" and are made available to all beneficiaries that share that need.

166. India submits that developing countries should not be presumed to have waived their MFN rights under Article I.1 of the GATT 1994 *vis-à-vis* other developing countries<sup>337</sup>, and we make no such presumption. In fact, we note that the Enabling Clause *specifically* allows developed countries to provide differential and more favourable treatment to developing countries "notwithstanding" the provisions of Article I.<sup>338</sup> With this in mind, and given that paragraph 3(c) of the Enabling Clause contemplates, in certain circumstances, differentiation among GSP beneficiaries, we cannot agree with India that the right to MFN treatment can be invoked by a GSP beneficiary *vis-à-vis* other GSP beneficiaries in the context of GSP schemes that meet the conditions set out in the Enabling Clause.

167. Finally, we note that, pursuant to paragraph 3(a) of the Enabling Clause, any "differential and more favourable treatment ... shall be designed to facilitate and promote the trade of developing countries and not to raise barriers to or create undue difficulties for the trade of any other contracting parties." This requirement applies, *a fortiori*, to any preferential treatment granted to one GSP beneficiary that is not granted to another.<sup>339</sup> Thus, although paragraph 2(a) does not prohibit *per se* the granting of different tariff preferences to different GSP beneficiaries<sup>340</sup>, and paragraph 3(c) even contemplates such differentiation under certain circumstances<sup>341</sup>, paragraph 3(a) requires that any positive response of a preference-granting country to the varying needs of developing countries not impose unjustifiable burdens on other Members.

<sup>337</sup> India's appellee's submission, para. 94.

<sup>338</sup> Compare para. 1 of the Enabling Clause ("Notwithstanding the provisions of Article I") with para. (a) of the 1971 Waiver Decision ("the provisions of Article I shall be waived ... to the extent necessary").

<sup>339</sup> We note in this respect that the language contained in paragraph 3(a) of the Enabling Clause is reflected in waivers referred to in *supra*, footnote 323.

<sup>340</sup> *Supra*, paras. 153-154.

<sup>341</sup> *Supra*, paras. 162-165.

168. Having examined the context of paragraph 2(a), we turn next to examine the object and purpose of the *WTO Agreement*. We note first that paragraph 7 of the Enabling Clause provides that "[t]he concessions and contributions made and the obligations assumed by developed and less-developed contracting parties under the provisions of the [GATT 1994] should promote the basic objectives of the [GATT 1994], including those embodied in the Preamble". As we have observed, the Preamble to the *WTO Agreement* provides that there is "need for positive efforts designed to ensure that developing countries, and especially the least developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development".<sup>342</sup> Similarly, the Preamble to the 1971 Waiver Decision provides that "a principal aim of the CONTRACTING PARTIES is promotion of the trade and export earnings of developing countries for the furtherance of their economic development".<sup>343</sup> These objectives are also reflected in paragraph 3(c) of the Enabling Clause, which states that the treatment provided under the Enabling Clause "shall ... be designed and, if necessary, modified, to respond positively to the development, financial and trade needs of developing countries".

169. Although enhanced market access will contribute to responding to the needs of developing countries *collectively*, we have also recognized that the needs of developing countries may vary over time. We are of the view that the objective of improving developing countries' "share in the growth in international trade", and their "trade and export earnings", can be fulfilled by promoting preferential policies aimed at those interests that developing countries have in common, *as well as* at those interests shared by sub-categories of developing countries based on their particular needs. An interpretation of "non-discriminatory" that does not require the granting of "identical tariff preferences"<sup>344</sup> allows not only for GSP schemes providing preferential market access to all beneficiaries, but also the possibility of additional preferences for developing countries with particular needs, provided that such additional preferences are not inconsistent with other provisions of the Enabling Clause, including the requirements that such preferences be "generalized" and "non-reciprocal". We therefore consider such an interpretation to be consistent with the object and purpose of the *WTO Agreement* and the Enabling Clause.

170. The Panel took the view, however, that the objective of "elimination of discriminatory treatment in international commerce"<sup>345</sup>, found in the Preamble to the GATT 1994, "contributes more

<sup>342</sup>*WTO Agreement*, Preamble, second recital.

<sup>343</sup>1971 Waiver Decision, Preamble, first recital.

<sup>344</sup>Panel Report, para. 7.161.

<sup>345</sup>*Ibid.*, para. 7.157 (quoting GATT 1994, Preamble, second recital).

to guiding the interpretation of "non-discriminatory"<sup>346</sup> than does the objective of ensuring that developing countries "secure ... a share in the growth in international trade commensurate with their development needs."<sup>347</sup> We fail to see on what basis the Panel drew this conclusion.

171. We next examine the relevance of paragraph 2(d) of the Enabling Clause<sup>348</sup> for the interpretation of "non-discriminatory" in footnote 3. The Panel characterized paragraph 2(d) as an "exception" to paragraph 2(a)<sup>349</sup> and relied on paragraph 2(d) to support its view that paragraph 2(a) requires "formally identical treatment".<sup>350</sup> In the Panel's view, if developed-country Members were entitled under paragraph 2(a) to differentiate between developing-country Members, then they would have been entitled under that paragraph alone to differentiate between developing and least-developed countries. Accordingly, "there would have been no need to include paragraph 2(d) in the Enabling Clause."<sup>351</sup>

172. We do not agree with the Panel that paragraph 2(d) is an "exception" to paragraph 2(a), or that it is rendered redundant if paragraph 2(a) is interpreted as allowing developed countries to differentiate in their GSP schemes between developing countries. To begin with, we note that the terms of paragraph 2 do not expressly indicate that each of the four sub-paragraphs thereunder is mutually exclusive, or that any one is an exception to any other. Moreover, in our view, it is clear from several provisions of the Enabling Clause that the drafters wished to emphasize that least-developed countries form an identifiable sub-category of developing countries with "special economic difficulties and ... particular development, financial and trade needs".<sup>352</sup> When a developed-country Member grants tariff preferences in favour of developing countries under paragraph 2(a), as we have already found<sup>353</sup>, footnote 3 imposes a requirement that such preferences be "non-discriminatory". In the absence of paragraph 2(d), a Member granting preferential tariff treatment only to least-developed countries would therefore need to establish, under paragraph 2(a), that this preferential treatment did not "discriminate" against other developing countries contrary to footnote 3. The inclusion of paragraph 2(d), however, makes clear that developed countries may accord preferential treatment to

<sup>346</sup>Panel Report, paras. 7.157-7.158.

<sup>347</sup>*Ibid.*, para. 7.155 (referring to *WTO Agreement*, Preamble, second recital).

<sup>348</sup>Paragraph 2(d) deals with special treatment of least-developed countries "in the context of any general or specific measures in favour of developing countries".

<sup>349</sup>Panel Report, para. 7.147.

<sup>350</sup>*Ibid.*, para. 7.145.

<sup>351</sup>*Ibid.*, para. 7.145.

<sup>352</sup>Enabling Clause, para. 6 (attached as Annex 2 to this Report). Similarly, paragraph 8 of the Enabling Clause refers to the "special economic situation and [the] development, financial and trade needs" of least-developed countries.

<sup>353</sup>*Supra*, paras. 145-148.

least-developed countries distinct from the preferences granted to other developing countries under paragraph 2(a). Thus, pursuant to paragraph 2(d), preference-granting countries need not establish that differentiating between developing and least-developed countries is "non-discriminatory". This demonstrates that paragraph 2(d) does have an effect that is different and independent from that of paragraph 2(a), even if the term "non-discriminatory" does not require the granting of "identical tariff preferences"<sup>354</sup> to all GSP beneficiaries.

173. Having examined the text and context of footnote 3 to paragraph 2(a) of the Enabling Clause, and the object and purpose of the *WTO Agreement* and the Enabling Clause, we conclude that the term "non-discriminatory" in footnote 3 does not prohibit developed-country Members from granting different tariffs to products originating in different GSP beneficiaries, provided that such differential tariff treatment meets the remaining conditions in the Enabling Clause. In granting such differential tariff treatment, however, preference-granting countries are required, by virtue of the term "non-discriminatory", to ensure that identical treatment is available to all similarly-situated GSP beneficiaries, that is, to all GSP beneficiaries that have the "development, financial and trade needs" to which the treatment in question is intended to respond.

174. For all of these reasons, we *reverse* the Panel's finding, in paragraphs 7.161 and 7.176 of the Panel Report, that "the term 'non-discriminatory' in footnote 3 [to paragraph 2(a) of the Enabling Clause] requires that identical tariff preferences under GSP schemes be provided to all developing countries without differentiation, except for the implementation of a priori limitations."<sup>355</sup>

C. *The Words "Developing Countries" in Paragraph 2(a) of the Enabling Clause*

175. In addition to the Panel's interpretation of the term "non-discriminatory" in footnote 3 of the Enabling Clause, the European Communities appeals the Panel's finding that "the term 'developing countries' in paragraph 2(a) should be interpreted to mean *all* developing countries, [except as regards] *a priori* limitations."<sup>356</sup> The Panel's interpretation of paragraph 2(a) is premised on its findings that (i) footnote 3 permits the granting of different tariff preferences to different GSP beneficiaries *only* for the purpose of *a priori* limitations,<sup>357</sup> and (ii) paragraph 3(c) permits the granting of different tariff preferences to different GSP beneficiaries *only* for the purposes of

<sup>354</sup>Panel Report, para. 7.161.

<sup>355</sup>Given our interpretation, which permits differentiation among GSP beneficiaries, it is not necessary for us to rule on whether *a priori* limitations are permitted under the Enabling Clause. (See also, *supra*, paras. 128-129)

<sup>356</sup>Panel Report, para. 7.174. (original italics) See also, European Communities' appellant's submission, para. 67.

<sup>357</sup>Panel Report, para. 7.170.

*a priori* limitations and preferential treatment in favour of least-developed countries.<sup>358</sup> We have concluded, contrary to the Panel, that footnote 3 and paragraph 3(c) do *not* preclude the granting of differential tariffs to different sub-categories of GSP beneficiaries, subject to compliance with the remaining conditions of the Enabling Clause. We find, therefore, that the term "developing countries" in paragraph 2(a) should not be read to mean "all" developing countries and, accordingly, that paragraph 2(a) does not prohibit preference-granting countries from according different tariff preferences to different sub-categories of GSP beneficiaries.

176. Accordingly, we also *reverse* the Panel's finding, in paragraph 7.174 of the Panel Report, that "the term 'developing countries' in paragraph 2(a) [of the Enabling Clause] should be interpreted to mean *all* developing countries, with the exception that where developed countries are implementing a priori limitations, 'developing countries' may mean *less than all* developing countries."

D. *Consistency of the Drug Arrangements with the Enabling Clause*

177. We turn next to examine the consistency of the Drug Arrangements with the Enabling Clause.

178. We recall that, with respect to the Enabling Clause, the only challenge by India before the Panel related to paragraph 2(a) and, in particular, footnote 3 thereto.<sup>359</sup> In response, the European Communities argued that it found contextual support for its interpretation of paragraph 2(a) in the requirement, contained in paragraph 3(c), to respond positively to the needs of developing countries.<sup>360</sup> In rejecting the European Communities' interpretation of paragraph 2(a), the Panel did not determine whether the Drug Arrangements satisfy the conditions set out in paragraph 3(c), but, rather, limited its discussion of paragraph 3(c) to the relevance of that provision as context for its interpretation of paragraph 2(a). Thus, the Panel made a finding of inconsistency only with respect to paragraph 2(a) of the Enabling Clause.<sup>361</sup> The European Communities appeals this finding of inconsistency with paragraph 2(a).

179. Although paragraph 3(c) informs the interpretation of the term "non-discriminatory" in footnote 3 to paragraph 2(a), as detailed above<sup>362</sup>, paragraph 3(c) imposes requirements that are

<sup>358</sup>Panel Report, para. 7.171.

<sup>359</sup>*Supra*, paras. 120-122.

<sup>360</sup>See Panel Report, para. 7.123; European Communities' first written submission to the Panel, paras. 70-71 and 149; and European Communities' second written submission to the Panel, paras. 48-52.

<sup>361</sup>Panel Report, para. 8.1(d).

<sup>362</sup>*Supra*, paras. 157-162.

separate and distinct from those of paragraph 2(a). We have already concluded that, where a developed-country Member provides additional tariff preferences under its GSP scheme to respond positively to widely-recognized "development, financial and trade needs" of developing countries within the meaning of paragraph 3(c) of the Enabling Clause, this "positive response" would not, as such, fail to comply with the "non-discriminatory" requirement in footnote 3 of the Enabling Clause<sup>363</sup>, even if such needs were not common or shared by all developing countries. We have also observed that paragraph 3(a) requires that any positive response of a preference-granting country to the varying needs of developing countries not impose unjustifiable burdens on other Members.<sup>364</sup> With these considerations in mind, and recalling that the Panel made no finding in this case as to whether the Drug Arrangements are inconsistent with paragraphs 3(a) and 3(c) of the Enabling Clause<sup>365</sup>, we limit our analysis here to paragraph 2(a) and do not examine *per se* whether the Drug Arrangements are consistent with the obligation contained in paragraph 3(c) to "respond positively to the development, financial and trade needs of developing countries" or with the obligation contained in paragraph 3(a) not to "raise barriers" or "create undue difficulties" for the trade of other Members.

180. We found above that the term "non-discriminatory" in footnote 3 to paragraph 2(a) of the Enabling Clause does not prohibit the granting of different tariffs to products originating in different sub-categories of GSP beneficiaries, but that identical tariff treatment must be available to all GSP beneficiaries with the "development, financial [or] trade need" to which the differential treatment is intended to respond.<sup>366</sup> The need alleged to be addressed by the European Communities' differential tariff treatment is the problem of illicit drug production and trafficking in certain GSP beneficiaries. In the context of this case, therefore, the Drug Arrangements may be found consistent with the "non-discriminatory" requirement in footnote 3 only if the European Communities proves, at a minimum, that the preferences granted under the Drug Arrangements are available to all GSP beneficiaries that are similarly affected by the drug problem.<sup>367</sup> We do not believe this to be the case.

<sup>363</sup> *Supra*, para. 165.

<sup>364</sup> *Supra*, para. 167.

<sup>365</sup> See *supra*, para. 134.

<sup>366</sup> *Supra*, para. 165.

<sup>367</sup> According to the European Communities, "the Drug Arrangements are *non-discriminatory* because the designation of the beneficiary countries is based only and exclusively on their development needs. All the developing countries that are similarly affected by the drug problem have been included in the Drug Arrangements". (European Communities' appellant's submission, para. 186 (original italics))

181. By their very terms, the Drug Arrangements are limited to the 12 developing countries designated as beneficiaries in Annex I to the Regulation.<sup>368</sup> Specifically, Article 10.1 of the Regulation states:

Common Customs Tariff *ad valorem* duties on [covered products] which originate in a country that according to Column I of Annex I benefits from [the Drug Arrangements] shall be entirely suspended.

182. Articles 10 and 25 of the Regulation, which relate specifically to the Drug Arrangements, provide no mechanism under which additional beneficiaries may be added to the list of beneficiaries under the Drug Arrangements as designated in Annex I. Nor does any of the other Articles of the Regulation point to the existence of such a mechanism with respect to the Drug Arrangements. Moreover, the European Communities acknowledged the absence of such a mechanism in response to our questioning at the oral hearing. This contrasts with the position under the "special incentive arrangements for the protection of labour rights" and the "special incentive arrangements for the protection of the environment", which are described in Article 8 of the Regulation. The Regulation includes detailed provisions setting out the procedure and substantive criteria that apply to a request by a beneficiary under the general arrangements described in Article 7 of the Regulation (the "General Arrangements") to become a beneficiary under either of those special incentive arrangements.<sup>369</sup>

183. What is more, the Drug Arrangements themselves do *not* set out any clear prerequisites—"objective criteria"<sup>370</sup>—that, if met, would allow for other developing countries "that are similarly affected by the drug problem"<sup>371</sup> to be *included* as beneficiaries under the Drug Arrangements.<sup>372</sup> Indeed, the European Commission's own Explanatory Memorandum notes that "the benefits of the drug regime ... are given without *any* prerequisite."<sup>373</sup> Similarly, the Regulation offers no criteria

<sup>368</sup> The 12 designated beneficiary countries are: Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Pakistan, Panama, Peru, and Venezuela. (Regulation, Annex I (Column I))

<sup>369</sup> Regulation, Title III.

<sup>370</sup> European Communities' appellant's submission, paras. 4 and 139.

<sup>371</sup> *Ibid.*, para. 186.

<sup>372</sup> In response to Question 4 posed by India at the First Panel Meeting, the European Communities confirmed that the Regulation does not set out objective criteria for designating beneficiary countries under the Drug Arrangements. The European Communities stated:

The criteria are not set out in the GSP Regulation. They are not contained in a public document.

(Panel Report, p. B-69, para. 5)

<sup>373</sup> Explanatory Memorandum to the Proposal for a Council Regulation applying a scheme of generalised tariff preferences for the period 1 January 2002 to 31 December 2004, para. 35 (emphasis added) (attached to Amended Proposal for a Council Regulation applying a scheme of generalised tariff preferences for the period 1 January 2002 to 31 December 2004, 2001/0131 (ACC), at p. 3) (Exhibit India-7 submitted by India to the Panel).

according to which a beneficiary could be *removed* specifically from the Drug Arrangements on the basis that it is no longer "similarly affected by the drug problem". Indeed, Article 25.3 expressly states that the evaluation of the effects of the Drug Arrangements described in Articles 25.1(b) and 25.2 "will be without prejudice to the continuation of the [Drug Arrangements] until 2004, and their possible extension thereafter." This implies that, even if the European Commission found that the Drug Arrangements were having no effect whatsoever on a beneficiary's "efforts in combating drug production and trafficking"<sup>374</sup>, or that a beneficiary was no longer suffering from the drug problem, beneficiary status would continue.<sup>375</sup> Therefore, even if the Regulation allowed for the list of beneficiaries under the Drug Arrangements to be modified, the Regulation itself gives no indication as to how the beneficiaries under the Drug Arrangements were chosen or what kind of considerations would or could be used to determine the effect of the "drug problem" on a particular country. In addition, we note that the Regulation does not, for instance, provide any indication as to how the European Communities would assess whether the Drug Arrangements provide an "adequate and proportionate response"<sup>376</sup> to the needs of developing countries suffering from the drug problem.

184. It is true that a country may be removed as a beneficiary under Annex I, either altogether or in respect of certain product sectors, for reasons that are not specific to the Drug Arrangements. Thus, Article 3 of the Regulation provides for the removal of a country from Annex I (and hence, from the General Arrangements and any other arrangements under which it is a beneficiary) if particular circumstances are met indicating that the country has reached a certain level of development. Article 12 provides for the removal of a country as a beneficiary under the General Arrangements and the Drug Arrangements with respect to a product sector where the country's level of development and competition has reached a certain threshold with respect to that sector. Neither Article 3 nor Article 12 appears to relate in any way to the degree to which the country is suffering from the "drug problem". Finally, Title V to the Regulation contains certain "Temporary Withdrawal and Safeguard Provisions" that are common to all the preferential arrangements under the Regulation. Although one reason for which the arrangements may be temporarily withdrawn is "shortcomings in customs controls on export or transit of drugs (illicit substances or precursors), or failure to comply with international conventions on money laundering"<sup>377</sup>, this reason applies equally to the General Arrangements, the Drug Arrangements, and the other special incentive arrangements. Moreover, as

<sup>374</sup>Regulation, Art. 25.1(b).

<sup>375</sup>In response to questioning at the oral hearing, the European Communities confirmed that, although the sixth recital to the Preamble of the Regulation provides that the Drug Arrangements "should be closely monitored", the list of beneficiaries will be unaffected by the monitoring described in Articles 25.1 and 25.2 of the Regulation.

<sup>376</sup>European Communities' appellant's submission, para. 133.

<sup>377</sup>Regulation, Art. 26.1(d).

the Panel appeared to recognize, this condition is not connected to the question of whether the beneficiary is a "seriously drug-affected country".<sup>378</sup>

185. We note, moreover, that the Drug Arrangements will be in effect until 31 December 2004.<sup>379</sup> Until that time, other developing countries that are "similarly affected by the drug problem" can be included as beneficiaries under the Drug Arrangements only through an amendment to the Regulation. The European Communities confirmed this understanding in response to questioning at the oral hearing.

186. Against this background, we fail to see how the Drug Arrangements can be distinguished from other schemes that the European Communities describes as "confined *ab initio* and permanently to a limited number of developing countries".<sup>380</sup> As we understand it, the European Communities' position is that such schemes would be discriminatory, whereas the Drug Arrangements are not because "all developing countries are potentially beneficiaries" thereof.<sup>381</sup> In seeking a waiver from its obligations under Article I:1 of the GATT 1994 to implement the Drug Arrangements, the European Communities explicitly acknowledged, however, that "[b]ecause the special arrangements are *only available* to imports originating in [the 12 beneficiaries of the Drug Arrangements], a waiver ... appears necessary".<sup>382</sup> This statement appears to undermine the European Communities' argument that "all developing countries are potentially beneficiaries of the Drug Arrangements" and, therefore, that the Drug Arrangements are "non-discriminatory".<sup>383</sup>

187. We recall our conclusion that the term "non-discriminatory" in footnote 3 of the Enabling Clause requires that identical tariff treatment be available to all similarly-situated GSP beneficiaries. We find that the measure at issue fails to meet this requirement for the following reasons. First, as the European Communities itself acknowledges, according to benefits under the Drug Arrangements to countries other than the 12 identified beneficiaries would require an amendment to the Regulation.

<sup>378</sup>Panel Report, para. 7.216.

<sup>379</sup>Regulation, Arts. 1.1 and 41.2. We understand that the Regulation has been extended to 31 December 2005; (Council Regulation (EC) No. 2211/2003 of 15 December 2003 amending Regulation (EC) No. 2501/2001 applying a scheme of generalised tariff preferences for the period from 1 January 2002 to 31 December 2004 and extending it to 31 December 2005, *Official Journal of the European Union*, L Series, No. 332 (19 December 2003), p. 1)

<sup>380</sup>European Communities' appellant's submission, para. 185.

<sup>381</sup>*Ibid.*, para. 186.

<sup>382</sup>Council for Trade in Goods, Request for a WTO Waiver, *New EC Special Tariff Arrangements to Combat Drug Production and Trafficking*, G/C/W/328, 24 October 2001, p. 2. (emphasis added)

<sup>383</sup>European Communities' appellant's submission, para. 186.

Such a "closed list" of beneficiaries cannot ensure that the preferences under the Drug Arrangements are available to all GSP beneficiaries suffering from illicit drug production and trafficking.

188. Secondly, the Regulation contains no criteria or standards to provide a basis for distinguishing beneficiaries under the Drug Arrangements from other GSP beneficiaries. Nor did the European Communities point to any such criteria or standards anywhere else, despite the Panel's request to do so.<sup>384</sup> As such, the European Communities cannot justify the Regulation under paragraph 2(a), because it does not provide a basis for establishing whether or not a developing country qualifies for preferences under the Drug Arrangements. Thus, although the European Communities claims that the Drug Arrangements are available to all developing countries that are "similarly affected by the drug problem"<sup>385</sup>, because the Regulation does not define the criteria or standards that a developing country must meet to qualify for preferences under the Drug Arrangements, there is no basis to determine whether those criteria or standards are discriminatory or not.

189. For all these reasons, we find that the European Communities has failed to prove that the Drug Arrangements meet the requirement in footnote 3 that they be "non-discriminatory". Accordingly, we *uphold*, for different reasons, the Panel's conclusion, in paragraph 8.1(d) of the Panel Report, that the European Communities "failed to demonstrate that the Drug Arrangements are justified under paragraph 2(a) of the Enabling Clause".

## VI. Findings and Conclusions

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

- (a) upholds the Panel's finding, in paragraph 7.53 of the Panel Report, that the Enabling Clause is an "exception" to Article I:1 of the GATT 1994;
- (b) upholds the Panel's finding, in paragraph 7.53 of the Panel Report, that the Enabling Clause "does not exclude the applicability" of Article I:1 of the GATT 1994;
- (c) modifies the Panel's finding, in paragraph 7.53 of the Panel Report, that the European Communities "bears the burden of invoking the Enabling Clause and justifying its Drug Arrangements" under that Clause, by finding that it was incumbent upon India to *raise* the Enabling Clause in making its claim of inconsistency with Article I:1 of the GATT 1994, but that the European Communities bore the burden of *proving* that

the Drug Arrangements satisfy the conditions of the Enabling Clause, in order to justify those Arrangements under that Clause; and finds, further, that India sufficiently raised paragraph 2(a) of the Enabling Clause in making its claim of inconsistency with Article I:1 before the Panel;

- (d) need not rule on the Panel's conclusion, in paragraphs 7.60 and 8.1(b) of the Panel Report, that the Drug Arrangements are inconsistent with Article I:1 of the GATT 1994;
  - (e) reverses the Panel's finding, in paragraphs 7.161 and 7.176 of the Panel Report, that "the term 'non-discriminatory' in footnote 3 [to paragraph 2(a) of the Enabling Clause] requires that identical tariff preferences under GSP schemes be provided to all developing countries without differentiation, except for the implementation of a priori limitations";
  - (f) reverses the Panel's finding, in paragraph 7.174 of the Panel Report, that "the term 'developing countries' in paragraph 2(a) [of the Enabling Clause] should be interpreted to mean *all* developing countries, with the exception that where developed countries are implementing a priori limitations, 'developing countries' may mean *less than all* developing countries"; and
  - (g) upholds, for different reasons, the Panel's conclusion, in paragraph 8.1(d) of the Panel Report, that the European Communities "failed to demonstrate that the Drug Arrangements are justified under paragraph 2(a) of the Enabling Clause".
191. The Appellate Body therefore recommends that the Dispute Settlement Body request the European Communities to bring Council Regulation (EC) No. 2501/2001, found in this Report, and in the Panel Report as modified by this Report, to be inconsistent with Article I:1 of the GATT 1994 and not justified under paragraph 2(a) of the Enabling Clause, into conformity with its obligations under the GATT 1994.

<sup>384</sup>See *supra*, footnote 372.

<sup>385</sup>European Communities' appellant's submission, para. 186.

Signed in the original at Geneva this 18th day of March 2004 by:

ANNEX 1

# WORLD TRADE ORGANIZATION

WT/DS246/7  
8 January 2004  
(04-0070)

Original: English

\_\_\_\_\_  
Georges Abi-Saab  
Presiding Member

\_\_\_\_\_  
Luiz Olavo Baptista  
Member

\_\_\_\_\_  
Giorgio Sacerdoti  
Member

## EUROPEAN COMMUNITIES – CONDITIONS FOR THE GRANTING OF TARIFF PREFERENCES TO DEVELOPING COUNTRIES

Notification of an Appeal by the European Communities  
under paragraph 4 of Article 16 of the Understanding on Rules  
and Procedures Governing the Settlement of Disputes ("DSU")

The following notification, dated 8 January 2004, from the Permanent Delegation of the European Commission, is being circulated to Members.

Pursuant to Article 16 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") and Rule 20 of the Working Procedures for Appellate Review, the European Communities hereby notifies its decision to appeal to the Appellate Body certain issues of law covered in the report of the panel established in response to the request from India in the dispute *European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries* (WT/DS246R).

The European Communities seeks review of the Panel's legal conclusion that the Special Arrangements to Combat Drug Production and Trafficking provided in Council Regulation (EC) No. 2501/2001 (the "Drug Arrangements") are inconsistent with Article I:1 of the *General Agreement on Tariff and Trade 1994* (the "GATT"). This conclusion is based on the following erroneous legal findings:

- that the Enabling Clause is an "exception" to Article I:1 of the GATT;
- that the Enabling Clause does not exclude the applicability of Article I:1 of the GATT;
- that the EC had the burden of proving that the Drug Arrangements were consistent with the Enabling Clause.

The above legal conclusion, and the related legal findings and interpretations are set out in paragraphs 7.31 to 7.60 and 8.1 (b) and (c) of the Panel report.

India did not make any claims under the Enabling Clause and, therefore, the Appellate Body should refrain from examining the consistency of the Drug Arrangements with the Enabling Clause. However, if the Appellate Body were to uphold the Panel's conclusion that the Drug Arrangements are inconsistent with Article I:1 of the GATT, or if the Appellate Body were to decide that India made a valid claim under the Enabling Clause, the European Communities appeals subsidiarily the Panel's

legal conclusion that the European Communities "failed to demonstrate that the Drug Arrangements are justified under paragraph 2(a) of the Enabling Clause". That conclusion is based on the following erroneous legal findings:

- that "the term "non-discriminatory" in footnote 3 to Paragraph 2(a) requires that identical tariff preferences under GSP schemes be provided to all developing countries without differentiation, except for the implementation of a priori limitations"; and
- that the term "developing countries" in Paragraph 2(a) means all developing countries.

This legal conclusion and the related legal findings and interpretations are set out in paragraphs 7.61-7.177 and 8.1(d) of the Panel report.

Finally the EC seeks review of the Panel's legal conclusion that the European Communities has nullified or impaired benefits accrued to India under GATT 1994, which is set out in paragraph 8.1(f) of the Panel report

## ANNEX 2

### DIFFERENTIAL AND MORE FAVOURABLE TREATMENT RECIPROCIITY AND FULLER PARTICIPATION OF DEVELOPING COUNTRIES

*Decision of 28 November 1979  
(L/4903)*

Following negotiations within the framework of the Multilateral Trade Negotiations, the CONTRACTING PARTIES *decide* as follows:

1. Notwithstanding the provisions of Article I of the General Agreement, contracting parties may accord differential and more favourable treatment to developing countries<sup>1</sup>, without according such treatment to other contracting parties.
2. The provisions of paragraph 1 apply to the following:<sup>2</sup>
  - (a) Preferential tariff treatment accorded by developed contracting parties to products originating in developing countries in accordance with the Generalized System of Preferences,<sup>3</sup>
  - (b) Differential and more favourable treatment with respect to the provisions of the General Agreement concerning non-tariff measures governed by the provisions of instruments multilaterally negotiated under the auspices of the GATT;
  - (c) Regional or global arrangements entered into amongst less-developed contracting parties for the mutual reduction or elimination of tariffs and, in accordance with criteria or conditions which may be prescribed by the CONTRACTING PARTIES, for the mutual reduction or elimination of non-tariff measures, on products imported from one another
  - (d) Special treatment of the least developed among the developing countries in the context of any general or specific measures in favour of developing countries.
3. Any differential and more favourable treatment provided under this clause:
  - (a) shall be designed to facilitate and promote the trade of developing countries and not to raise barriers to or create undue difficulties for the trade of any other contracting parties;
  - (b) shall not constitute an impediment to the reduction or elimination of tariffs and other restrictions to trade on a most-favoured-nation basis;

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<sup>1</sup> The words "developing countries" as used in this text are to be understood to refer also to developing territories.

<sup>2</sup> It would remain open for the CONTRACTING PARTIES to consider on an *ad hoc* basis under the GATT provisions for joint action any proposals for differential and more favourable treatment not falling within the scope of this paragraph.

<sup>3</sup> As described in the Decision of the CONTRACTING PARTIES of 25 June 1971, relating to the establishment of "generalized, non-reciprocal and non discriminatory preferences beneficial to the developing countries" (BISD 18S/24).

(c) shall in the case of such treatment accorded by developed contracting parties to developing countries be designed and, if necessary, modified, to respond positively to the development, financial and trade needs of developing countries.

4. Any contracting party taking action to introduce an arrangement pursuant to paragraphs 1, 2 and 3 above or subsequently taking action to introduce modification or withdrawal of the differential and more favourable treatment so provided shall.<sup>4</sup>

(a) notify the CONTRACTING PARTIES and furnish them with all the information they may deem appropriate relating to such action;

(b) afford adequate opportunity for prompt consultations at the request of any interested contracting party with respect to any difficulty or matter that may arise. The CONTRACTING PARTIES shall, if requested to do so by such contracting party, consult with all contracting parties concerned with respect to the matter with a view to reaching solutions satisfactory to all such contracting parties.

5. The developed countries do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of developing countries, i.e., the developed countries do not expect the developing countries, in the course of trade negotiations, to make contributions which are inconsistent with their individual development, financial and trade needs. Developed contracting parties shall therefore not seek, neither shall less-developed contracting parties be required to make, concessions that are inconsistent with the latter's development, financial and trade needs.

6. Having regard to the special economic difficulties and the particular development, financial and trade needs of the least-developed countries, the developed countries shall exercise the utmost restraint in seeking any concessions or contributions for commitments made by them to reduce or remove tariffs and other barriers to the trade of such countries, and the least-developed countries shall not be expected to make concessions or contributions that are inconsistent with the recognition of their particular situation and problems.

7. The concessions and contributions made and the obligations assumed by developed and less-developed contracting parties under the provisions of the General Agreement should promote the basic objectives of the Agreement, including those embodied in the Preamble and in Article XXXVI. Less-developed contracting parties expect that their capacity to make contributions or negotiated concessions or take other mutually agreed action under the provisions and procedures of the General Agreement would improve with the progressive development of their economies and improvement in their trade situation and they would accordingly expect to participate more fully in the framework of rights and obligations under the General Agreement.

8. Particular account shall be taken of the serious difficulty of the least-developed countries in making concessions and contributions in view of their special economic situation and their development, financial and trade needs.

9. The contracting parties will collaborate in arrangements for review of the operation of these provisions, bearing in mind the need for individual and joint efforts by contracting parties to meet the development needs of developing countries and the objectives of the General Agreement.

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<sup>4</sup> Nothing in these provisions shall affect the rights of contracting parties under the General Agreement.



**World Trade Organization**

**United States – Subsidies on Upland Cotton**

**Report of the Appellate Body, 3 March 2005**

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Argentina – Footwear (EC)	Appellate Body Report, <i>Argentina – Safeguard Measures on Imports of Footwear</i> , WT/DS121/AB/R, adopted 12 January 2000, DSR 2000:1, 515
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Canada – Wheat Exports and Grain Imports	Appellate Body Report, <i>Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain</i> , WT/DS276/AB/R, adopted 27 September 2004
Chile – Price Band System	Appellate Body Report, <i>Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products</i> , WT/DS207/AB/R, adopted 23 October 2002

EC – Asbestos	Appellate Body Report, <i>European Communities – Measures Affecting Asbestos and Asbestos-Containing Products</i> , WT/DS135/AB/R, adopted 5 April 2001, DSR 2001:VII, 3243
EC – Bananas III	Appellate Body Report, <i>European Communities – Regime for the Importation, Sale and Distribution of Bananas</i> , WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591
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EC – Sardines	Appellate Body Report, <i>European Communities – Trade Description of Sardines</i> , WT/DS231/AB/R, adopted 23 October 2002
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India – Autos	Panel Report, <i>India – Measures Affecting the Automobile Sector</i> , WT/DS146/R, WT/DS175/R and Corr.1, adopted 5 April 2002
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Korea – Alcoholic Beverages	Panel Report, <i>Korea – Taxes on Alcoholic Beverages</i> , WT/DS75/R, WT/DS84/R, adopted 17 February 1999, as modified by the Appellate Body Report, WT/DS75/AB/R, WT/DS84/AB/R, DSR 1999:1, 44
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US – Certain EC Products	Appellate Body Report, <i>United States – Import Measures on Certain Products from the European Communities</i> , WT/DS165/AB/R, adopted 10 January 2001, DSR 2001:I, 373
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US – Line Pipe	Appellate Body Report, <i>United States – Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea</i> , WT/DS202/AB/R, adopted 8 March 2002
US – Section 211 Appropriations Act	Appellate Body Report, <i>United States – Section 211 Omnibus Appropriations Act of 1998</i> , WT/DS176/AB/R, adopted 1 February 2002, DSR 2002:II, 589
US – Shrimp (Article 21.5 – Malaysia)	Appellate Body Report, <i>United States – Import Prohibition of Certain Shrimp and Shrimp Products – Recourse to Article 21.5 of the DSU by Malaysia</i> , WT/DS58/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6481
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US – Steel Safeguards	Appellate Body Report, <i>United States – Definitive Safeguard Measures on Imports of Certain Steel Products</i> , WT/DS248/AB/R, WT/DS249/AB/R, WT/DS251/AB/R, WT/DS252/AB/R, WT/DS253/AB/R, WT/DS254/AB/R, WT/DS258/AB/R, WT/DS259/AB/R, adopted 10 December 2003

US – Wheat Gluten	Appellate Body Report, <i>United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities</i> , WT/DS166/AB/R, adopted 19 January 2001, DSR 2001:II, 717
US – Wool Shirts and Blouses	Appellate Body Report, <i>United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India</i> , WT/DS33/AB/R and Corr.1, adopted 23 May 1997, DSR 1997:1, 323
US – Wool Shirts and Blouses	Panel Report, <i>United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India</i> , WT/DS33/R, adopted 23 May 1997, as upheld by the Appellate Body Report, WT/DS33/AB/R, DSR 1997:1, 343

WORLD TRADE ORGANIZATION  
APPELLATE BODY

TABLE OF ABBREVIATIONS USED IN THIS REPORT

Abbreviation	Description
AMS	Aggregate Measurement of Support
<i>Anti-Dumping Agreement</i>	<i>Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994</i>
CCC	Commodity Credit Corporation
CCP payments	counter-cyclical payments
DP payments	direct payments
DSB	Dispute Settlement Body
DSU	<i>Understanding on Rules and Procedures Governing the Settlement of Disputes</i>
ETI Act	FSC Repeal and Extraterritorial Income Exclusion Act of 2000, Public Law 106-519
FAIR Act of 1996	Federal Agriculture Improvement and Reform Act of 1996, Public Law 104-127
FSRI Act of 2002	Farm Security and Rural Investment Act of 2002, Public Law 107-171
GATT 1994	<i>General Agreement on Tariffs and Trade 1994</i>
GSM 102	General Sales Manager 102
GSM 103	General Sales Manager 103
M.L.A payments	market loss assistance payments
peace clause	Article 13 of the <i>Agreement on Agriculture</i>
Panel Report	Panel Report, <i>United States – Subsidies on Upland Cotton</i> ("US – Upland Cotton"), WT/DS267/R, and Corr. 1, 8 September 2004
PFC payments	production flexibility contract payments
price-contingent subsidies	Marketing loan program payments, Step 2 payments, market loss assistance payments, and counter-cyclical payments
SCGP	Supplier Credit Guarantee Program
<i>SCM Agreement</i>	<i>Agreement on Subsidies and Countervailing Measures</i>
Step 2 payments	User marketing (Step 2) payments
USDA	United States Department of Agriculture
<i>Vienna Convention</i>	<i>Vienna Convention on the Law of Treaties</i> , done at Vienna, 23 May 1969, 1155 U.N.T.S. 331; 8 International Legal Materials 679
<i>Working Procedures</i>	<i>Working Procedures for Appellate Review</i>
WTO	World Trade Organization
<i>WTO Agreement</i>	<i>Marrakesh Agreement Establishing the World Trade Organization</i>

**United States – Subsidies on Upland Cotton**

AB-2004-5

United States, *Appellant/Appellee*  
Brazil, *Appellant/Appellee*

Present:

Janow, Presiding Member  
Baptista, Member  
Ganesan, Member

Argentina, *Third Participant*  
Australia, *Third Participant*  
Benin, *Third Participant*  
Canada, *Third Participant*  
Chad, *Third Participant*  
China, *Third Participant*  
European Communities, *Third Participant*  
India, *Third Participant*  
New Zealand, *Third Participant*  
Pakistan, *Third Participant*  
Paraguay, *Third Participant*  
Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu, *Third Participant*  
Venezuela, *Third Participant*

**I. Introduction**

1. The United States and Brazil each appeals certain issues of law and legal interpretations developed in the Panel Report, *United States – Subsidies on Upland Cotton* (the "Panel Report").<sup>1</sup> The Panel was established on 18 March 2003 to consider claims by Brazil regarding various United States measures<sup>2</sup> that Brazil alleged constituted actionable subsidies within the meaning of Part III of the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*"), prohibited subsidies within the meaning of Part II of the *SCM Agreement*, export subsidies within the scope of the *Agreement on Agriculture*, and/or subsidies actionable under Article XVI of the *General Agreement on Tariffs and Trade 1994* (the "GATT 1994"). Brazil also alleged that certain of these measures were inconsistent with Article III:4 of the GATT 1994. The United States argued that some

<sup>1</sup>WT/DS267/R, 8 September 2004.

<sup>2</sup>Brazil made claims in respect of marketing loan program payments, user marketing (Step 2) payments, production flexibility contract payments, market loss assistance payments, direct payments, counter-cyclical payments, crop insurance payments, cottonseed payments, export credit guarantees and the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 (Public Law 106-519) (the "ETI Act of 2000"). Brazil also made claims regarding legislation and regulations underlying certain of these programs. All of these measures are described more fully in paragraphs 7.200 to 7.250 of the Panel Report and are discussed further in the relevant sections of this Report.

of the measures were domestic support measures that were exempt from certain actions by virtue of paragraphs (a) and (b) of Article 13 of the *Agreement on Agriculture*.

2. The Panel Report was circulated to Members of the World Trade Organization (the "WTO") on 8 September 2004. In paragraph 7.194 of its Report, the Panel made the following findings with respect to whether certain measures fell within its terms of reference:

The Panel rules that the following measures, as addressed in document WT/DS267/7, are within its terms of reference:

- (i) export credit guarantees to facilitate the export of United States upland cotton, and other eligible agricultural commodities;
- (ii) production flexibility contract payments and market loss assistance payments[.]<sup>3</sup>

3. The Panel also ruled, in paragraph 7.196 of its Report, that:

... in its request for consultations in document WT/DS267/1, Brazil provided a statement of available evidence with respect to export credit guarantees under the GSM 102, GSM 103 and SCGP programmes relating to upland cotton and eligible agricultural commodities other than upland cotton, as required by Article 4.2 of the *SCM Agreement*.

4. With respect to the substantive issues raised by the parties, the Panel set out the following conclusions in paragraph 8.1 of its Report:

- (a) Article 13 of the *Agreement on Agriculture* is not in the nature of an affirmative defence;
- (b) PFC payments<sup>4</sup>, DP payments<sup>5</sup>, and the legislative and regulatory provisions which establish and maintain the DP programme, do not satisfy the condition in paragraph (a) of Article 13 of the *Agreement on Agriculture*;

<sup>3</sup>The Panel also ruled that production flexibility contract payments, market loss assistance payments, direct payments and counter-cyclical payments to upland cotton producers with respect to non-upland cotton base acres; cottonseed payments under both Public Law 106-224 and Public Law 107-25 (for the 2000 crop); storage payments and interest subsidies that implement the marketing loan program; and payments under programs and provisions within the Panel's terms of reference made after the date on which the Panel was established, were all within its terms of reference. (See Panel Report, para. 7.194(iii)-(vi)). The Panel also ruled that certain other measures fell outside of its terms of reference: see Panel Report, para. 7.195

<sup>4</sup>Production flexibility contract payments. Production flexibility contract payments are described by the Panel in paras. 7.212 ff of the Panel Report and are discussed further *infra*, para. 251.

<sup>5</sup>Direct payments. Direct payments are described by the Panel in paras. 7.218 ff of the Panel Report and are discussed further *infra*, para. 312.

(c) United States domestic support measures considered in Section VII:D of this report<sup>6</sup> grant support to a specific commodity in excess of that decided during the 1992 marketing year and, therefore, do not satisfy the conditions in paragraph (b) of Article 13 of the *Agreement on Agriculture* and, therefore, are not exempt from actions based on paragraph 1 of Article XVI of the *GATT 1994* or Articles 5 and 6 of the *SCM Agreement*;

(d) concerning United States export credit guarantees under the GSM 102<sup>7</sup>, GSM 103<sup>8</sup> and SCGP<sup>9</sup> export credit guarantee programmes:

- (i) in respect of exports of upland cotton and other unscheduled agricultural products supported under the programmes, and in respect of one scheduled product (rice):
  - United States export credit guarantees under the GSM 102, GSM 103 and SCGP export credit guarantee programmes are export subsidies applied in a manner which results in circumvention of United States' export subsidy commitments, within the meaning of Article 10.1 of the *Agreement on Agriculture* and they are therefore inconsistent with Article 8 of the *Agreement on Agriculture*;
  - as they do not conform fully to the provisions of Part V of the Agreement on Agriculture, they do not satisfy the condition in paragraph (c) of Article 13 of the *Agreement on Agriculture* and, therefore, are not exempt from actions based on Article XVI of the *GATT 1994* or Articles 3, 5 and 6 of the *SCM Agreement*;

<sup>6</sup>In Section VII:D of the Panel Report, the Panel considered the following measures for purposes of calculating support during the implementation period in which Article 13 of the *Agreement on Agriculture* applies: marketing loan payments, user marketing (Step 2) payments to domestic users (and not to exporters), production flexibility contract payments, market loss assistance payments, direct payments, counter-cyclical payments, crop insurance payments, and cottonseed payments for the 1999, 2000, and 2002 crops of cottonseed. (Panel Report, para. 7.537 and footnote 695 thereto)

<sup>7</sup>General Sales Manager 102 ("GSM 102"). The United States' export credit guarantee programs, including the GSM 102 program, are described by the Panel in paras. 7.236 ff of the Panel Report and are discussed further *infra*, paras. 586-587.

<sup>8</sup>General Sales Manager 103 ("GSM 103"). The United States' export credit guarantee programs, including the GSM 103 program, are described by the Panel in paras. 7.236 ff of the Panel Report and are discussed further *infra*, paras. 586 and 588.

<sup>9</sup>Supplier Credit Guarantee Program ("SCGP"). The United States' export credit guarantee programs, including the SCGP program, are described by the Panel in paras. 7.236 ff of the Panel Report and are discussed further *infra*, paras. 586 and 589.

- United States export credit guarantees under the GSM 102, GSM 103 and SCGP export credit guarantee programmes are provided by the United States government at premium rates which are inadequate to cover long-term operating costs and losses of the programmes within the meaning of item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*, and therefore constitute *per se* export subsidies prohibited by Articles 3.1(a) and 3.2 of the *SCM Agreement*.

(ii) however, in respect of exports of unscheduled agricultural products not supported under the programmes and other scheduled agricultural products:

- the United States has established that export credit guarantees under the GSM 102, GSM 103 and SCGP export credit guarantee programmes have not been applied in [a] manner which either results in, or which threatens to lead to, circumvention of United States export subsidy commitments within the meaning of Article 10.1 and that they therefore are not inconsistent with Article 8 of the *Agreement on Agriculture*;

- in these circumstances, and as Brazil has also not made a prima facie case before this Panel that the programmes do not conform fully to the provisions of Part V of the *Agreement on Agriculture*, this Panel must treat them as if they are exempt from actions based on Article XVI of the *GATT 1994* and Article 3 of the *SCM Agreement* in this dispute.

(e) concerning section 1207(a) of the FSRI Act of 2002<sup>10]</sup> providing for user marketing (Step 2) payments to exporters of upland cotton:

(i) section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters of upland cotton is an export subsidy, listed in Article 9.1(a) of the *Agreement on Agriculture*, provided in respect of upland cotton, an unscheduled product. It is, therefore, inconsistent with the United States' obligations under Articles 3.3 and 8 of the *Agreement on Agriculture*;

(ii) as it does not conform fully to the provisions of Part V of the *Agreement on Agriculture*, it does not satisfy the condition in paragraph (c) of Article 13 of the *Agreement on Agriculture* and, therefore, is not exempt from actions based on Article XVI of the *GATT 1994* or Articles 3, 5 and 6 of the *SCM Agreement*;

(iii) section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters of upland cotton is an export subsidy prohibited by Articles 3.1(a) and 3.2 of the *SCM Agreement*.

(f) concerning section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to domestic users of upland cotton: it is an import substitution subsidy prohibited by Articles 3.1(b) and 3.2 of the *SCM Agreement*;

(g) concerning serious prejudice to the interests of Brazil:

(i) the effect of the mandatory price-contingent United States subsidy measures – marketing loan programme payments, user marketing (Step 2) payments, MLA payments<sup>11]</sup> and CCP payments<sup>12]</sup> -- is significant price suppression in the same world market within the meaning of Article 6.3(c) of the *SCM Agreement* constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*;

(ii) however, Brazil has not established that:

- the effect of PFC payments, DP payments and crop insurance payments is significant price suppression in the same world market within the meaning of Article 6.3(c) of the *SCM Agreement* constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*; or

<sup>11]</sup>Market loss assistance payments. Market loss assistance payments are described by the Panel in paras. 7.216 ff of the Panel Report and are discussed further *infra*, para. 251 and footnote 368.

<sup>12]</sup>Counter-cyclical payments. Counter-cyclical payments are described by the Panel in paras. 7.223 ff of the Panel Report and are discussed further *infra*, footnote 370.

<sup>10]</sup>Farm Security and Rural Investment Act of 2002 (the "FSRI Act of 2002"); Public Law 107-171.

the effect of the United States subsidy measures listed in paragraph 7.1107 of Section VII:G of this report<sup>13</sup> is an increase in the United States' world market share within the meaning of Article 6.3(d) of the *SCM Agreement* constituting serious prejudice within the meaning of Article 5(c) of the *SCM Agreement*.

- (h) concerning the ETI Act of 2000:
  - (i) Brazil has not made a prima facie case before this Panel that the ETI Act of 2000 and alleged export subsidies provided thereunder are inconsistent with Articles 10.1 and 8 of the *Agreement on Agriculture* in respect of upland cotton;
  - (ii) with respect to the condition in Article 13(c)(ii) of the *Agreement on Agriculture*, as Brazil has also not made a prima facie case before this Panel that they do not conform fully to the provisions of Part V of the *Agreement on Agriculture* in respect of upland cotton, this Panel must treat them as if they are exempt from actions based on Article XVI of the *GATT 1994* and Article 3 of the *SCM Agreement* in this dispute. (footnotes omitted)

5. Based on these conclusions, the Panel recommended that the United States bring the measures listed in paragraphs 8.1(d)(i) and 8.1(e) of the Panel Report into conformity with the *Agreement on Agriculture*<sup>14</sup>, and withdraw the prohibited subsidies listed in paragraphs 8.1(d)(i), 8.1(e) and 8.1(f) of the Panel Report without delay and, at the latest, within six months of the date of adoption of the Panel Report by the Dispute Settlement Body (the "DSB") or 1 July 2005 (whichever is earlier).<sup>15</sup> With respect to the "mandatory price-contingent United States subsidy measures" addressed in paragraph 8.1(g)(i) of the Panel Report, the Panel noted that, pursuant to Article 7.8 of the *SCM Agreement*, "upon adoption of [the Panel Report] the United States is under an obligation to 'take appropriate steps to remove the adverse effects or ... withdraw the subsidy'."<sup>16</sup>

<sup>13</sup>The Panel listed the following measures in paragraph 7.1107 of its Report: "(i) user marketing (Step 2) payments to domestic users and exporters; (ii) marketing loan programme payments; (iii) production flexibility contract payments; (iv) market loss assistance payments; (v) direct payments; (vi) counter-cyclical payments; (vii) crop insurance payments; (viii) cottonseed payments for the 2000 crop; and (ix) legislative and regulatory provisions currently providing for the payment of measures in (i), (ii), (v), (vi) and (vii) above".

<sup>14</sup>Panel Report, para. 8.3(a).

<sup>15</sup>*Ibid.*, paras. 8.3(b) and 8.3(c).

<sup>16</sup>*Ibid.*, para. 8.3(d).

6. On 18 October 2004, the United States notified the DSB of its intention to appeal certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel, pursuant to paragraph 4 of Article 16 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), and filed a Notice of Appeal<sup>17</sup> pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "*Working Procedures*").<sup>18</sup> On 28 October 2004, the United States filed its appellant's submission.<sup>19</sup> On 2 November 2004, Brazil filed an other appellant's submission.<sup>20</sup> On 16 November 2004, Brazil and the United States each filed an appellee's submission.<sup>21</sup>

7. On 16 November 2004, Argentina, Australia, Canada, China, the European Communities, and New Zealand each filed a third participant's submission, and Benin and Chad filed a joint third participants' submission.<sup>22</sup> India, Pakistan, Paraguay, Venezuela, and the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu notified the Appellate Body of their intention to appear at the oral hearing.<sup>23</sup>

8. After consultation with the Appellate Body Secretariat, Brazil and the United States noted, in letters filed on 10 December 2004, that it would not be possible for the Appellate Body to circulate its Report in this appeal within the 90-day time limit referred to in Article 17.5 of the DSU. Brazil and the United States agreed that additional time was needed for several reasons: the issues arising in this

<sup>17</sup>WT/DS267/17, 18 October 2004, attached as Annex 1 to this Report.

<sup>18</sup>WT/AB/WP/4, 1 May 2003. Revised *Working Procedures* were circulated by the Appellate Body during the course of these proceedings (WT/AB/WP/5, 4 January 2005). These revised *Working Procedures*, however, apply only to appeals initiated after 1 January 2005 and therefore did not apply to this appeal.

<sup>19</sup>Pursuant to Rule 21(1) of the *Working Procedures*. In a letter dated 1 November 2004, Brazil, without requesting action by the Appellate Body, drew attention to the failure by the United States to submit its appellant's submission in a timely fashion. Brazil observed that the United States' appellant's submission was submitted on 28 October 2004 after the deadline of 5:00 p.m. that had been established by the Division in the *Working Schedule* issued pursuant to Rule 26 of the *Working Procedures*.

<sup>20</sup>Pursuant to Rule 23(1) of the *Working Procedures*.

<sup>21</sup>Pursuant to Rules 22 and 23(3) of the *Working Procedures*, respectively.

<sup>22</sup>Pursuant to Rule 24(1) of the *Working Procedures*.

<sup>23</sup>Pursuant to Rule 24 of the *Working Procedures*. The notifications were received on the following dates: India, 16 November 2004; Pakistan, 17 November 2004; Paraguay, 17 November 2004; Venezuela, 17 November 2004; and the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu, 18 November 2004.

appeal were particularly numerous and complex compared to prior appeals, which increased the burden on the Appellate Body and WTO translation services; WTO translation services were unavailable during the WTO holiday period; and the Appellate Body was likely to be considering two or three other appeals during the same period. Brazil and the United States accordingly confirmed that they would deem the Appellate Body Report in this proceeding, issued no later than 3 March 2005, to be an Appellate Body Report circulated pursuant to Article 17.5 of the DSU.<sup>24</sup>

9. The oral hearing in this appeal was held on 13-15 December 2004. The participants and third participants presented oral arguments (with the exception of Pakistan, Paraguay, and Venezuela) and responded to questions posed by the Members of the Division hearing the appeal.

## II. Arguments of the Participants and the Third Participants

### A. *Claims of Error by the United States – Appellant*

#### 1. Domestic Support

##### (a) Terms of Reference – Expired Measures

10. The United States contends that the Panel was wrong to reject its argument that payments under the expired production flexibility contract and market loss assistance programs were outside the Panel's terms of reference. The United States asks the Appellate Body to reverse the Panel's finding because these measures had expired before Brazil requested consultations.

11. Article 4.2 of the DSU provides that consultations are to cover "any representations made by another Member concerning measures affecting the operation of any covered agreement taken within the territory of the former".<sup>25</sup> The United States submits that measures that have expired before a request for consultations cannot be measures that are "affecting the operation of any covered agreement" at the time the request is made; consequently, they cannot be measures within the scope of the "dispute" referred to in Article 4.7, with respect to which a complaining Member can request the establishment of a panel. It was common ground that the legislation authorizing production flexibility contract payments and market loss assistance payments expired before Brazil's consultation and panel requests. They thus cannot have been within the scope of consultations under Article 4.2.

<sup>24</sup>On 16 December 2004, the Appellate Body notified the Chair of the DSB that the expected date of circulation of its Report was 3 March 2005. (WT/DS267/18, 20 December 2004)

<sup>25</sup>United States' appellant's submission, para. 501. (emphasis added by the United States)

12. In response to the Panel's concern that the United States' position would mean that subsidy payments made in the past might never be the subject of challenge in WTO dispute settlement, the United States distinguishes between recurring and non-recurring subsidies. A non-recurring subsidy is a type of subsidy the benefits of which are allocated to future production. As such, a non-recurring subsidy can be regarded as continuing in existence beyond the period during which it is granted, and may continue to be actionable even after the authorizing program or legislation has expired. A recurring subsidy, by contrast, is typically provided year after year and is provided for current rather than future production. Once production has occurred and a measure has been replaced or superseded, there would no longer be any measure in existence to challenge. Market loss assistance and production flexibility contract payments were both subsidies paid for particular fiscal or crop years. As such, the benefit of these subsidies should have been attributed only to the particular year of payment and should not have been attributed to subsequent years. Thus, by the time of Brazil's consultation and panel requests<sup>26</sup>, the only measure to consult upon and at issue under the DSU was the 2002 marketing year production flexibility contract payments; the other payments were all outside the Panel's terms of reference.

13. According to the United States, the Panel's conclusion is also inconsistent with Article 6.2 of the DSU, which requires that a panel request "identify the specific measures at issue". A measure that has expired cannot be a measure that is "at issue". This is confirmed by the context provided by Article 3.7 of the DSU, which contemplates the withdrawal of measures found to be inconsistent with the covered agreements, and Article 19.1 of the DSU, which contemplates a measure that "is inconsistent" with a covered agreement.

14. In addition to appealing the Panel's finding that payments under the expired production flexibility contract and market loss assistance programs were within its terms of reference, the United States lists this Panel finding as an example of the Panel's failure to meet the requirements of Article 12.7 of the DSU, which requires panels to set out the findings of fact, the applicability of relevant provisions, and the basic rationale behind its findings.

### (b) Article 13(a) of the *Agreement on Agriculture – Planting Flexibility Limitations*

15. The United States appeals the Panel's finding that production flexibility contract payments, direct payments, and the legislative and regulatory provisions that establish and maintain the direct payment program<sup>27</sup> are not exempt from actions by virtue of paragraph (a) of Article 13 of the

<sup>26</sup>Request for Consultations by Brazil, WT/DS267/1, G/L/571, G/SCM/D49/1, G/AG/GEN/54, 3 October 2002; Request for the Establishment of a Panel by Brazil, WT/DS267/7, 7 February 2003.

<sup>27</sup>Panel Report, para. 7.388.

*Agreement on Agriculture* (the "peace clause"). The United States observes that the sole basis for this finding was the Panel's conclusion that these measures do not conform fully to paragraph 6(b) of Annex 2 of the *Agreement on Agriculture* (the "green box")<sup>28</sup>, which conditions green box coverage and exemption under the peace clause upon the amount of payments not being related to the type or volume of production. The United States argues that, to make this finding, the Panel had to find that banning a recipient from producing a certain range of products was the same as conditioning the amount of payment on the type of production. The United States submits that paragraph 6(b) of Annex 2 permits such a partial ban.

16. The United States points out that, in order to receive production flexibility contract payments or direct payments, a producer is not required to produce a particular (or, indeed, any) crop. Instead, payments are based on a farm's historical acreage and yields during a base period. Farmers may plant any commodity or crop, subject to limitations concerning the planting of fruits and vegetables (and wild rice in the case of direct payments).<sup>29</sup> Where fruits, vegetables, or wild rice are produced, payments are eliminated or reduced, subject to certain exceptions.

17. Although the ordinary meaning of the term "related to" implies a relation or connection that could be positive or negative, the ordinary meaning does not identify which type of connection is meant under paragraph 6(b) of Annex 2. Turning to the context, the United States notes that this paragraph speaks of the "amount of such payments" not being related to or based on the type or volume of production. The United States argues that "[t]he Panel assumes that the 'amount of such payments' can be related to the current type of production (that is, of fruits or vegetables) because in some circumstances a recipient that produces fruits or vegetables receives less payment than that recipient otherwise would have been entitled to."<sup>30</sup> However, given that the payment relating to fruits, vegetables, or wild rice is zero, the "amount of such payments" is not related to fruit, vegetable, or wild rice production, because for the acres concerned, there is no payment at all. As regards the phrase "production ... undertaken by the producer" in paragraph 6(b), the United States notes that the term "undertaken" means, *inter alia*, to "attempt". In this case, the planting flexibility limitations ban a recipient from producing a certain range of products. This does not relate to the production "attempted"; rather, it relates to the type of production *not* attempted. Taken together, the ordinary meaning of the terms "amount of such payments" and "production ... undertaken" indicate that

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<sup>28</sup>Paragraph 6(b) of Annex 2 to the *Agreement on Agriculture* provides that:

The amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period.

<sup>29</sup>Panel Report, paras. 7.376-7.382.

<sup>30</sup>United States' appellant's submission, para. 26 (referring to Panel Report, para. 7.383).

payments are not "related to" current production within the meaning of paragraph 6(b) when a Member conditions payments on a recipient not producing certain products.

18. According to the United States, this interpretation is consistent with the "fundamental requirement" set out in paragraph 1 of Annex 2 of the *Agreement on Agriculture* that measures exempted from reduction commitments "have no, or at most minimal, trade-distorting effects or effects on production". The United States submits that "a condition that a recipient not produce certain products serves the fundamental requirement of Annex 2".<sup>31</sup> The United States further argues that the effect of the planting flexibility limitations at issue is minimal and does not result in increased production, pointing to evidence on the record showing that 47 per cent of farms receiving production flexibility contract payments or direct payments in the 2002 marketing year planted no upland cotton at all. Indeed, in finding that Brazil had not established that the effect of the United States' decoupled income support payments was significant price suppression, the Panel implicitly found that production flexibility contract payments and direct payments do not have more than minimal effects on production. For the United States, an explicit decision not to support a particular type of production does not relate the amount of payments to the type of production undertaken by the producer. Rather, such a decision serves the fundamental requirement that "green box" measures have no more than minimal trade-distorting effects, because a measure that conditions payment on not producing something does not create production inducements.

19. The United States also submits that the context provided by paragraph 6(e) confirms its reading of paragraph 6(b). Paragraph 6(e) provides: "[n]o production shall be required in order to receive such payments"; it does not preclude a Member from requiring non-production. A proper reading reveals that paragraphs 6(b) and 6(e) serve different purposes. As a Member may, under paragraph 6(e), require a recipient not to produce, it would not make sense to then prohibit a Member, under paragraph 6(b), from making the amount of payment contingent on fulfilling the requirement not to produce.

20. Furthermore, the United States argues that the Panel was incorrect to find contextual support for its interpretation of paragraph 6(b) in paragraphs 11(b) and 11(e) of Annex 2. Paragraphs 6(b) and 11(b) contain similar requirements about not relating payments to the type or volume of production, but paragraph 11(b) refers explicitly to paragraph 11(e), which permits requirements not to produce a particular product. The United States maintains that the context in which paragraphs 6(b) and 11(b) appear is very different. In the context of paragraph 6, an explicit authorization of requirements not to produce is not required as it is already implicit within the

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<sup>31</sup>United States' appellant's submission, para. 22.

provisions. The United States notes that paragraph 11 pertains to payments "to assist the financial or physical restructuring of a producer's operations".<sup>32</sup> Although such aid is for restructuring of operations that will continue to produce, paragraph 11(e) imposes a constraint on the degree to which a government can interfere in the form that restructuring will take, by requiring that payments must not "mandate or in any way designate the agricultural products to be produced". A requirement not to produce certain products could be understood to fall within the prohibition in paragraph 11(e) against "in any way" designating the products to be produced. In order to allow such requirements, paragraph 11(e) clarifies that they are permitted. The United States submits that, in the light of the broad prohibition in paragraph 11(e), the requirement in paragraph 11(b) could be understood to preclude conditioning payment on *not* producing certain products, as this could be understood to be designating, in some way, the products to be produced. According to the United States, this would undermine the prohibition in paragraph 11(e). The cross-reference in paragraph 11(b) to the exception in paragraph 11(e) thus simply serves to make clear that conditioning payments on *not* producing does not conflict with the prohibition under paragraph 11(e) on designating in any way the products to be produced.

21. In addition, the United States submits that the Panel's reading of paragraph 6(b) would require payments even if a recipient's production was illegal. Therefore, a Member would be prohibited from reducing or eliminating payments for prohibited types of production such as narcotic crops, unapproved biotech varieties, or environmentally damaging production.

(c) Article 13(b) of the *Agreement on Agriculture*

22. The United States appeals the Panel's finding that the United States' non-green box domestic support measures are not exempt from actions by virtue of paragraph (b) of Article 13 of the *Agreement on Agriculture*. The Panel found that those measures failed to satisfy, for each marketing year from 1999-2002, the proviso to Article 13(b)(ii), which reads "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year".

(i) *Interpretation of "support to a specific commodity"*

23. The United States contends that the Panel erred in interpreting the phrase "support to a specific commodity" in Article 13(b)(i). The ordinary meaning of this phrase encompasses "assistance' or 'backing' specially ... pertaining to a particular' agricultural crop' or ... for a 'precise,

exact, definite' agricultural crop".<sup>33</sup> The ordinary meaning implies that support to a specific commodity excludes support that is not for a precise, exact, definite agricultural crop.

24. Context for interpreting the phrase "support to a specific commodity" may be found in other provisions of the *Agreement on Agriculture* that contain the terms "support", "specific" and "commodity". Annex 3 deals with "Calculation of the Aggregate Measurement of Support" ("AMS"). Paragraph 1 of that Annex clarifies that two types of support are to be calculated: first, support is calculated "on a product-specific basis", and, second, "[s]upport which is non-product specific shall be totalled into one non-product-specific AMS in total monetary terms". Article 1(a) of the *Agreement on Agriculture* contains this same distinction between "support ... provided for an agricultural product in favour of the producers of the basic agricultural product" and a residual category of "non-product-specific ... support". Article 1(h) also makes this distinction by dividing total support into "non-product-specific support" and "support for basic agricultural products". For the United States, the terms "support for basic agricultural products" in Article 1(h) and "support ... provided for an agricultural product in favour of the producers of the basic agricultural product" in Article 1(a) are virtually synonymous with the phrase "support for a specific commodity" in Article 13(b)(ii). The context of these provisions thus suggests that this phrase also means product-specific support.

25. The Panel relied on the different choice of specific words in Articles 1(a) and 13(b)(ii) in finding that the former was not pertinent to the interpretation of the latter. The United States argues, however, that the concept of product-specific support is expressed in different terms in different places in the *Agreement on Agriculture*. Indeed, nowhere in the Agreement is the precise phrase "product-specific support" used, although the Panel had no difficulty in finding that such a concept exists. Thus, the fact that the phrase "product-specific support" was not used in Article 13 does not prevent an interpretation that the concept nevertheless applies.

26. The United States disagrees with the Panel's reasoning that the categories of product-specific and non-product-specific support are not pertinent to the analysis under Article 13(b) because the proviso to Article 13(b)(ii) begins with the phrase "such measures", which refers to all the domestic support measures falling under Article 6 identified in the chapeau to Article 13(b), and not just to product-specific and non-product-specific support subject to reduction commitments. The United States notes that the Panel itself recognized that certain domestic support measures falling under Article 6 could be excluded from the comparison of support under Article 13(b)(ii): the Panel's approach "exclud[es] all other support, which either grants support to other specific commodities or

<sup>32</sup>United States' appellant's submission, para. 45 (quoting paragraph 11(a) of Annex 2 to the *Agreement on Agriculture*).

<sup>33</sup>United States' appellant's submission, para. 85 (quoting *The New Shorter Oxford English Dictionary*, L. Brown (ed.) (Clarendon Press, 1993), Vol. 2, pp. 2972 and 3152).

does not grant support to any specific commodity".<sup>34</sup> The Panel also noted that "Brazil acknowledges this implicitly in that it does not challenge very widely available support, such as infrastructure or irrigation subsidies, some of which, presumably, deliver support to upland cotton either directly or indirectly".<sup>35</sup> Thus the mere fact that all domestic support measures falling under Article 6 are identified in the chapeau of Article 13(b) does not resolve the issue of whether a particular measure grants "support to a specific commodity".

27. The United States finds relevant context in Articles 3 and 6 of the *Agreement on Agriculture*. Under these provisions, a Member must comply with its domestic support reduction commitments. These commitments, however, are expressed on a total aggregate basis with no product-specific caps on support. Because there are no product-specific caps, a Member can comply with its overall reduction commitments while increasing support to a particular agricultural commodity. Article 13(b) provides shelter from actions for domestic support measures that conform to the reduction commitments. However, Members recognized that an increase in product-specific support, even within overall reduction commitment levels, could present an enhanced risk of production or trade effects. The proviso to Article 13(b)(i) thus makes the exemption it provides conditional upon a Member not shifting support between commodities such that the level of product-specific support exceeds that decided for any one commodity in the 1992 marketing year.

28. Turning to the measures at issue, the United States observes that the Panel's reasoning means that payments to producers that do not produce cotton at all are deemed to be "support to upland cotton". The United States contends that the Panel erred in finding that payments based on past production during a base period currently grant support to production of that commodity. Production flexibility contract payments, market loss assistance, direct payments, and counter-cyclical payments do not specify upland cotton as a commodity to which they grant support, as the Panel implied. In fact, payments under these programs do not require any production at all. Indeed, uncontested facts show that 47 per cent of the farms receiving these payments did not plant a single acre of upland cotton. The United States asserts that payments cannot be deemed to grant support to a crop the recipient does not produce. Such payments do not grant support to a specific commodity. In the light of the context provided by Articles 1(a), 1(h), and 6.4 and Annex 3 of the *Agreement on Agriculture*, such payments are properly seen as non-product-specific support to agricultural producers in general.

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<sup>34</sup>United States' appellant's submission, para. 96 (quoting Panel Report, para. 7.502).

<sup>35</sup>*Ibid.*

29. The United States observes that the Panel correctly rejected all six of the methodologies proposed by Brazil for allocating decoupled payments as support to upland cotton. However, in the "Attachment to Section VII:D" the Panel included one allocation methodology that reduced payments on base acres to account only for the number of acres planted with upland cotton. The United States argues that, by including this methodology, the Panel endorsed it as an alternative to its own approach, in the event that the Panel's approach was found to be incorrect. The Panel labelled its finding in this regard as factual; however, the finding is patently legal, not sheltered from appellate review. The United States also contends that any methodology that allocates payments under the decoupled programs to upland cotton planted as a result of independent producer decisions beyond government control cannot reflect the support to a specific commodity that a Member has "decided", and thus is not appropriate for Article 13(b)(ii).

(ii) *Calculation methodology for price-based measures*

30. The United States submits that the Panel did not compare properly the support current measures "grant" to that "decided" during the 1992 marketing year. The ordinary meaning of "grant" is to "bestow as a favour" or "[g]ive or confer (a possession, a right, etc.) formally".<sup>36</sup> The ordinary meaning of "decide" is to "[d]etermine on as a settlement, pronounce in judgement" and "[c]ome to a determination or resolution *that, to do, whether*".<sup>37</sup> Read in their context, as two halves of a comparison, these terms must allow the relevant "support" to be compared. The phrase "grant support", read in the light of the verb "decided", means the support that Members determine to "bestow" or "give or confer", and thus the focus of the peace clause comparison is on the support a Member decides. The United States submits that the Panel essentially agreed "that the Peace Clause proviso compares the support a Member determines through its measures, not 'support [that] was spent due to reasons beyond the control of the government'".<sup>38</sup>

31. Against this background, the United States contends that a proper application of Article 13(b)(ii) must reflect the way in which the United States "decided" support in the 1992 and 1999-2002 marketing years. In those years, the support "decided" by the United States was a rate of support.

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<sup>36</sup>United States' appellant's submission, para. 65 (quoting *The New Shorter Oxford English Dictionary*, L. Brown (ed.) (Clarendon Press, 1993), Vol. 1, p. 1131).

<sup>37</sup>*Ibid.*, para. 65 (quoting *The New Shorter Oxford English Dictionary*, L. Brown (ed.) (Clarendon Press, 1993), Vol. 1, p. 607). (original emphasis)

<sup>38</sup>*Ibid.*, para. 66 (quoting Panel Report, para. 7.487).

32. The United States submits that it was possible for the Panel to have recourse to the rules for the calculation of the AMS set out in Annex 3 of the *Agreement on Agriculture*, so long as the appropriate calculation method was used. In the case of price-based measures (such as marketing loan program payments in the 1992 marketing year and the implementation period, and deficiency payments in the 1992 marketing year only), paragraph 10 of Annex 3 permits two different approaches: budgetary outlays or using "the gap between the fixed reference price and the applied administered price multiplied by the quantity of production eligible to receive the administered price" ("price gap" methodology). In the context of a comparison under the peace clause, only the price gap methodology reflects the support "decided" by the United States' price-based measures. By focusing on the gap between an external reference price (here, the actual price for determining rates for the years 1986-1988) and the applied administered price, the price gap methodology eliminates movements in market prices as a component of the measurement of support and focuses solely on those elements that a Member can control. By holding the reference price "fixed", support measured using a price gap calculation shows the effect of changes in the level of support decided by a Member, rather than changes in budgetary outlays that result from movements in market prices that Members do not control.

(iii) *Recalculation of the peace clause comparison*

33. On the basis of its arguments regarding calculation methodology and the interpretation of the phrase "support to a specific commodity", the United States recalculates the support to upland cotton in the 1992 marketing year and implementation period support between 1999-2002 using the price gap methodology for marketing loan program payments and deficiency payments, on the one hand, and excluding production flexibility contract payments, market loss assistance, direct payments, and counter-cyclical payments, on the other hand, because they are not "support to a specific commodity". The result is that the United States' support to upland cotton does not exceed that decided in the 1992 marketing year in any year of the implementation period. The United States accordingly requests the Appellate Body to reverse the Panel's findings regarding Article 13(b) and to find that it is entitled to the protection of the peace clause.

2. Serious Prejudice

(a) Significant Price Suppression under Article 6.3(c) of the *SCM Agreement*

34. The United States appeals the Panel's finding that the effect of the price-contingent subsidies<sup>39</sup> is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement* constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*. The United States asks the Appellate Body to reverse the Panel's finding that the effect of the price-contingent subsidies is significant price suppression. The United States also submits that the Panel failed to set out the findings of fact, the applicability of relevant provisions, and the basic rationale behind several aspects of this finding, as required by Article 12.7 of the DSU.

35. First, the United States submits that the Panel erred in interpreting the term "same market" in Article 6.3(c) of the *SCM Agreement* as including a "world market". Under Article 6.3(c), the price suppression must occur in a market that includes the subsidized product and the like product. Identifying the relevant market as a world market fails to give meaning to the word "same" in Article 6.3(c) because "there is no 'other' world market where the products can be found".<sup>40</sup> The United States relies on Article 6.6 and Annex V of the *SCM Agreement* on "Procedures for Developing Information Concerning Serious Prejudice" to substantiate this view. The United States also indicates that, although the subsidized product and the like product must be found in the same market, the Panel did not make a finding that United States and Brazilian upland cotton compete in the world market that it had identified for upland cotton. In addition, the United States contends that the Panel acknowledged that different conditions of competition would prevail in the markets of different Members and that, therefore, each market in which the two products are found would need to be examined separately.

36. The United States submits that the Panel's reading of "same market" in Article 6.3(c) contradicts its reasoning in relation to Article 6.3(d) of the *SCM Agreement*, which, according to the United States, demonstrates that no "world market" price prevails in any "world market" for upland cotton. Moreover, according to the United States, the Panel should have focused on the effect of the challenged subsidies on the *Brazilian* price of upland cotton, rather than their effect on any "world

<sup>39</sup>The Panel characterized marketing loan program payments, user marketing (Step 2) payments, market loss assistance payments, and counter-cyclical payments as "price-contingent" subsidies. (Panel Report, para. 8.1(g)(i))

<sup>40</sup>United States' appellant's submission, para. 311.

market" price, because only significant suppression of Brazilian prices could lead to serious prejudice to the interests of Brazil under Article 5(c) of the *SCM Agreement*.

37. Secondly, the United States argues that, in finding significant price suppression, the Panel "prejudged the result of its analysis of the effect of the subsidy".<sup>41</sup> According to the United States, the Panel used circular logic: first, assuming causation in finding price suppression, and then, using its conclusion on price suppression to support its finding of causation. In addition, the Panel failed to take into account the effect of removing the price-contingent subsidies on all participants in the relevant market. Even if removing these subsidies would lead to lower United States production of cotton (which the United States contests), other producers could be expected to enter the market to increase supply. These supply changes would need to be included in assessing the effect on prices of removing the price-contingent subsidies. The United States also claims that, in concluding that the price suppression it had found was "significant", the Panel should have identified the degree of price suppression it had found and should have explained why it regarded this degree as "significant". The United States argues that, in failing to do so, the Panel failed to comply with Article 12.7 of the DSU.

38. Thirdly, the United States contends that the Panel erred in finding that "the effect of" the price-contingent subsidies is significant price suppression under Article 6.3(c) of the *SCM Agreement*. The United States refers to the Panel's conclusion that the price-contingent subsidies are linked to world prices for upland cotton, "thereby numbing the response of United States producers to production adjustment decisions when prices are low".<sup>42</sup> However, according to the United States, the "relevant economic decision"<sup>43</sup> for a farmer is what to plant and, at the time of planting, the relevant price is what the farmer expects to receive when the crop is subsequently harvested, not the current price. Therefore, the Panel should have examined whether the price-contingent subsidies stimulate *planting* of upland cotton, rather than whether they stimulate *production* or harvesting. The United States submits that the Panel failed to set out the basic rationale for its analysis of the "effect of the subsidy" as required by Article 12.7.

39. The United States also suggests that the Panel failed to examine evidence showing that the price-contingent subsidies did not suppress upland cotton prices: United States planting of cotton acreage corresponded with expected market prices of cotton and competing crops; changes in United States cotton acreage corresponded with changes by cotton farmers throughout the world; and the United States' share of world cotton production was stable during the relevant period. In addition, the

<sup>41</sup>United States' appellant's submission, para. 158.

<sup>42</sup>*Ibid.*, para. 162 (quoting Panel Report, para. 7.1308).

<sup>43</sup>*Ibid.*, para. 161.

Panel's identification of the relative shares of world cotton exports cannot demonstrate the effect of the subsidy in the absence of an analysis of competition between United States cotton and cotton from other sources. Moreover, according to the United States, the Panel's finding of a "discernible temporal coincidence"<sup>44</sup> between suppressed market prices and the price-contingent subsidies is flawed and, in any case, could involve only correlation and not causation.

40. The United States further disputes, in relation to the Panel's reasoning in determining the "effect" of the subsidy, the Panel's conclusion that a comparison between the average total cost of production and market revenue in the United States demonstrates that the effect of the price-contingent subsidies is significant price suppression. As reflected in economics literature, farmers make planting decisions based on *variable* rather than *total* costs of production. The Appellate Body's decision in *Canada – Dairy (Article 21.5 – New Zealand and US)* is not relevant to this issue. Had the Panel examined variable costs, it would have seen that United States upland cotton producers more than covered their variable costs from 1997 to 2002, apart from in 2001. In addition, even if average total costs were not covered, the evidence before the Panel demonstrates that farmers had other sources of income to cover the shortfall.

41. Fourthly, the United States argues that the Panel erred in finding that Brazil need not demonstrate, and that the Panel need not find, the amount of the challenged subsidies that benefits upland cotton in establishing serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*. The United States contends that the Panel "misunderstood"<sup>45</sup> the United States' argument as requiring the transposition of methodologies from Part V to Part III of the *SCM Agreement*. Instead, it is the text of Articles 5(c) and 6.3(c) that requires a quantification of benefit. Articles 5(c) and 6.3(c) of the *SCM Agreement* both use the word "subsidy", which is defined in Article 1 as involving the conferral of a benefit, as confirmed by Article 14 of the *SCM Agreement*. Article 6.3(c) refers to a "subsidized product". Therefore, what is at issue is the amount of the subsidy that benefits a particular product. This reading is supported by Article 6.8 of the *SCM Agreement*, which provides for panels to determine serious prejudice on the basis of, *inter alia*, information submitted under Annex V of the *SCM Agreement*. According to the United States, this includes information necessary to establish the amount of subsidization (paragraph 2 of Annex V) and information concerning the amount of the subsidy (paragraph 5 of Annex V).

42. For Brazil's claims to succeed, therefore, the United States maintains that the challenged subsidies would have to subsidize upland cotton and confer a benefit on United States "producers,

<sup>44</sup>United States' appellant's submission, para. 208 (referring to Panel Report, paras. 7.1351-7.1352).

<sup>45</sup>*Ibid.*, para. 258.

users, and/or exporters of upland cotton".<sup>46</sup> In addition, any benefit conferred by the challenged subsidies on products other than upland cotton cannot be included in determining the effect of the subsidies. However, the Panel attributed all counter-cyclical and market loss assistance payments to upland cotton. In fact, counter-cyclical and market loss assistance payments to recipients who did not produce upland cotton did not benefit upland cotton at all and therefore could not have caused serious prejudice and, in fact, fell outside the Panel's terms of reference altogether. As for counter-cyclical and market loss assistance payments to recipients who produced both upland cotton and other products, the Panel should have allocated the payments across the different products in assessing the effects of the payments in respect of upland cotton. Annex IV of the *SCM Agreement*<sup>47</sup> provides an "economically neutral" allocation methodology<sup>48</sup>, and paragraphs 2 and 5 of Annex V of the *SCM Agreement* provide support for the argument that it may be necessary to allocate subsidies across the total value of the recipient's sales. As the Panel did not identify the amount of counter-cyclical and market loss assistance payments benefitting upland cotton, its serious prejudice finding regarding those payments is invalid. In addition, the United States submits that this amounted to a failure by the Panel to set out the basic rationale behind its findings and recommendations in accordance with Article 12.7 of the DSU.

43. Along similar lines, the United States contends that the Panel should have determined the extent to which subsidies provided with respect to *raw* cotton benefit *processed* cotton. Instead, the Panel "improperly assumed"<sup>49</sup> that subsidies provided to producers of raw cotton flowed to producers of processed cotton. The United States maintains that the Appellate Body's conclusion in *US – Softwood Lumber II* that a subsidy bestowed on an input cannot be presumed to have passed through to the processed product is based on the definition of a subsidy, which applies to both Part III and Part V of the *SCM Agreement*.<sup>50</sup> Therefore, according to the United States, the Panel erred in finding that "pass-through" principles do not apply to Part III of the *SCM Agreement*.

44. Finally, the United States asserts that the Panel erred in making serious prejudice findings with respect to the price-contingent subsidies for marketing years 1999 to 2001. Even if the Panel was not required to determine the amount of the benefit flowing from the price-contingent subsidies to the subsidized product, the Panel had to determine whether the benefit from these subsidies continued

<sup>46</sup>United States' appellant's submission, para. 245 (quoting Brazil's request for establishment of a panel, *supra*, footnote 26, p. 1).

<sup>47</sup>Calculation of the Total Ad Valorem Subsidization (Paragraph 1(a) of Article 6)".

<sup>48</sup>United States' appellant's submission, para. 269.

<sup>49</sup>*Ibid.*, para. 303.

<sup>50</sup>*Ibid.*, paras. 304 and 305 (referring to Appellate Body Report, *US – Softwood Lumber II*, paras. 140 and 142).

when the Panel was established in 2002. This is because, under Article 11 of the DSU, the Panel could make findings only with respect to subsidies that could "form part of Brazil's claims"<sup>51</sup> and, under Article 19.1 of the DSU, the Panel could make recommendations only with respect to measures that still exist. In addition, the United States maintains that the Panel "failed to adequately set out the legal basis for its examination of subsidies that no longer existed at the time of panel establishment" as required by Article 12.7 of the DSU.<sup>52</sup>

45. According to the United States, an annually recurring subsidy should be "allocated" or "expensed"<sup>53</sup> to the year to which it relates, whereas a non-recurring subsidy, such as an investment subsidy or equity infusion, should be allocated over time. In the United States' view, a payment no longer confers a benefit after the year to which it is allocated, and therefore it is no longer a "subsidy" under Article 1 of the *SCM Agreement*. Price-contingent subsidies for marketing years 1999 to 2001 were annually recurring subsidies that the Panel should have allocated to those years. The United States argues that the Panel did not find that these subsidies had "continuing effects" when the Panel was established and, therefore, that the Panel could not have found that these subsidies were "causing present serious prejudice".<sup>54</sup>

46. For these reasons, the United States requests the Appellate Body to reverse the Panel's finding that the effect of the price-contingent subsidies is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement* constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*.

### 3. Import Substitution Subsidies and Export Subsidies

#### (a) Step 2 Payments

##### (i) *To domestic users*

47. The United States claims that the Panel erred in concluding that user marketing (Step 2) payments ("Step 2 payments") provided to domestic users of United States upland cotton, under Section 1207(a) of the FSRI Act of 2002, constitute import substitution subsidies that are inconsistent with Articles 3.1(b) and 3.2 of the *SCM Agreement*.

<sup>51</sup>United States' appellant's submission, para. 296.

<sup>52</sup>*Ibid.*, para. 327.

<sup>53</sup>*Ibid.*, para. 283.

<sup>54</sup>*Ibid.*, para. 292.

48. In the United States' view, the Panel's conclusion fails to give meaning to the introductory phrase "Except as provided in the Agreement on Agriculture" in Article 3 of the *SCM Agreement*. This phrase applies not only to export subsidies covered by Article 3.1(a) of the *SCM Agreement*, but also to import substitution subsidies covered by Article 3.1(b). The United States contends that giving proper meaning to the introductory phrase of Article 3 of the *SCM Agreement* requires treating Step 2 payments to domestic users as domestic support subject to reduction commitments under Article 6 of the *Agreement on Agriculture*.

49. The United States points out that paragraph 7 of Annex 3 of the *Agreement on Agriculture* requires that "[m]easures directed at agricultural processors shall be included [within a WTO Member's AMS] to the extent that such measures benefit the producers of the basic agricultural products". This is consistent with the objective of the *Agreement on Agriculture* of providing for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time. The United States submits that it has regularly reported Step 2 payments among the domestic support measures it provides to agricultural producers and includes them in the calculation of total AMS. Thus, the United States asserts, provided that they are within its domestic support reduction commitments, Step 2 payments to domestic users are not inconsistent with the United States' WTO obligations.

50. The United States explains that the lack of any reference to domestic content subsidies in Article 13(b) of the *Agreement on Agriculture* does not support the Panel's interpretation. Article 13(b) does not refer to Article 3 of the *SCM Agreement* because the substantive obligation of Article 3.1(b) does not apply to domestic content subsidies in favour of agricultural producers.

51. Consequently, the United States requests that the Appellate Body reverse the Panel's finding that Step 2 payments to domestic users of United States upland cotton are import substitution subsidies that are inconsistent with Articles 3.1(b) and 3.2 of the *SCM Agreement*.

(ii) *To exporters*

52. The United States claims that the Panel erred in concluding that Step 2 payments provided to exporters of United States upland cotton, under Section 1207(a) of the FSRI Act of 2002, are export subsidies covered by Article 9.1(a) of the *Agreement on Agriculture* and, therefore, inconsistent with Articles 3.3 and 8 of that Agreement. The United States also asserts that the Panel erroneously concluded that Step 2 payments to exporters are inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*, because they are not exempted from action by Article 13(c) of the *Agreement on Agriculture*.

53. The United States argues that Step 2 payments are not contingent on export performance because upland cotton does not need to be exported to trigger eligibility; domestic users are also eligible. The program under which Step 2 payments are granted is indifferent as to whether the recipient of the payment is an exporter or a domestic user. Step 2 payments to exporters and domestic users are governed by a single legislative provision and a single set of regulations. The form and payment rate to domestic users and exporters are identical, and payments are made from a unified fund. Rather than being an export-contingent subsidy, the United States reports Step 2 payments as product-specific amber box domestic support for cotton within its AMS.

54. The United States submits that the facts in this case are similar to those before the panel in *Canada – Dairy*, where the panel found that payments contingent on use, without regard to the nature of the use, do not involve an export subsidy for purposes of Articles 9 and 10 of the *Agreement on Agriculture*.<sup>55</sup> The distinctions drawn by the Panel between the circumstances in this case and those in *Canada – Dairy* are based on a mischaracterization by the Panel of facts in the latter case.<sup>56</sup> Finally, the United States contends that the Panel's finding in respect of Step 2 payments to *exporters* seems to be based on the Panel's determination to find that Step 2 payments to *domestic users* are a prohibited import substitution subsidy.

55. The United States therefore requests that the Appellate Body reverse the Panel's finding that Step 2 payments to exporters are an export subsidy listed in Article 9.1(a) that is inconsistent with the United States' obligations under Articles 3.3 and 8 of the *Agreement on Agriculture*. The United States also requests that the Appellate Body reverse the Panel's findings that Step 2 payments to exporters are not exempt from action under Article 13(c) of the *Agreement on Agriculture* and are inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*.

(b) Export Credit Guarantees

(i) *Panel's terms of reference*

56. The United States asserts that the Panel erred in concluding that export credit guarantees<sup>57</sup> to facilitate the export of United States agricultural commodities other than upland cotton were within its

<sup>55</sup>United States' appellant's submission, paras. 444-445 (referring to Panel Report, *Canada – Dairy*, para. 7.41 and footnote 496 to para. 7.124).

<sup>56</sup>*Ibid.*, paras. 447-452 (referring to Panel Report, paras. 7.718 and 7.725).

<sup>57</sup>The export credit guarantees at issue are the General Sales Manager 102 and 103 programs and the Supplier Credit Guarantee Program, which are described *infra*, paras. 586-589. See also Panel Report, paras. 7.236-7.244.

terms of reference. According to the United States, there is a clear progression between the measures included in the request for consultations under Article 4 of the DSU and the measures identified in the request for the establishment of a panel, which forms the basis for a panel's terms of reference.<sup>58</sup> The United States contends that a measure that is not included in the request for consultations may not form part of a panel's terms of reference.

57. In this case, the United States argues, the Panel erred in finding that Brazil's request for consultations identified export credit guarantees to agricultural commodities other than upland cotton as challenged measures. A plain reading of Brazil's request for consultations does not support the Panel's conclusion. The request identified the challenged measures as "subsidies provided to US producers, users and/or exporters of upland cotton".<sup>59</sup> Although footnote 1 to this sentence reads "Except with respect to export credit guarantee programs as explained below", none of the subsequent references to export credit guarantees in the request for consultations identified other United States agricultural commodities. Moreover, the statement of evidence attached to Brazil's request for consultations, pursuant to Article 4 of the *SCM Agreement*, did not mention commodities other than upland cotton, providing further proof that the request for consultations did not extend beyond export credit guarantees for upland cotton. That the request for consultations did not include export credit guarantees to other agricultural commodities is confirmed by the fact that Brazil included new language in its request for the establishment of a panel.

58. According to the United States, the Panel also erred in finding that "actual" consultations included export credit guarantees to agricultural commodities other than upland cotton. The fact that Brazil posed written questions to the United States about export credit guarantees for other commodities does not mean that Brazil and the United States held consultations about the topic. Were it otherwise, a complaining party could unilaterally alter the scope of consultations without regard to the requirements of Article 4.4 of the DSU, the time-frames, and the impact on third parties seeking to determine whether to join the consultations. The Panel also ignored the fact that, at the first consultations meeting, the United States expressed the view that Brazil's request with respect to export credit guarantees was clearly limited to upland cotton, and that no discussion of export credit guarantees for any commodity other than upland cotton took place during the consultations. The United States also argues that what is determinative of the scope of consultations is the text of Brazil's request for consultations and not the text of Brazil's written questions.

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<sup>58</sup>United States' appellant's submission, para. 466 (referring to Appellate Body Report, *Brazil – Aircraft*, para. 131).

<sup>59</sup>*Ibid.*, para. 457 (quoting the Request for Consultations by Brazil, *supra*, footnote 26).

59. The United States contends that the facts in this case are similar to those in *US – Certain EC Products*. In that case, the Appellate Body found that a particular measure was not part of the panel's terms of reference because it was not the subject of consultations.<sup>60</sup> Similarly, in this case, export credit guarantees to other agricultural commodities may not form part of the Panel's terms of reference because they were not the subject of consultations.

60. The United States therefore requests that the Appellate Body reverse the Panel's conclusion that export credit guarantees to United States agricultural commodities other than upland cotton were within the Panel's terms of reference. The United States adds that, because the Panel had no authority to make findings with respect to export credit guarantees for agricultural commodities other than upland cotton, all of the Panel's findings with respect to such commodities must also be reversed.

(ii) *Statement of available evidence*

61. The United States submits that the Panel erroneously concluded that Brazil provided a statement of available evidence with respect to export credit guarantee measures relating to United States agricultural commodities other than upland cotton, as required by Article 4.2 of the *SCM Agreement*.

62. The United States explains that the statement of evidence that was annexed to Brazil's request for consultations contains two paragraphs specifically referring to the United States' export credit guarantee programs. The Panel correctly noted that the first paragraph is textually limited to upland cotton.<sup>61</sup> The United States submits, however, that the Panel failed to draw the proper conclusion about the second paragraph. Although the second paragraph does not refer to upland cotton, it contains no suggestion that it expands on the programs described in the preceding paragraph, which refers to export credit guarantee programs that allegedly provide certain benefits to United States upland cotton. In the context of the paragraph that precedes it, the second paragraph must be understood to refer to the same programs—that is, to export credit guarantee programs that allegedly provide certain benefits to upland cotton. In addition, the United States points out that the second paragraph in Brazil's request for consultations does not refer to any commodity. Consequently, even if the second paragraph is construed to refer to programs that provide benefits to products other than cotton, it is difficult to see how that paragraph meets the requirements of Article 4.2 of the

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<sup>60</sup>United States' appellant's submission, para. 485 (referring to Appellate Body Report, *US – Certain EC Products*, para. 70).

<sup>61</sup>*Ibid.*, para. 495 (referring to Panel Report, para. 7.84).

*SCM Agreement*, as it does not provide information about the "existence" or "nature" of the subsidies allegedly provided by the export credit guarantee programs to products other than upland cotton.

63. The United States therefore requests that the Appellate Body reverse the Panel's finding and that it find, instead, that Brazil did not provide a statement of available evidence with respect to the United States' export credit guarantee programs as they relate to agricultural commodities other than upland cotton.

(iii) *Article 10.2 of the Agreement on Agriculture*

64. The United States alleges that the Panel erred in finding that the United States' export credit guarantee programs in respect of exports of upland cotton and other unscheduled agricultural products, and in respect of one scheduled product (i.e., rice), are export subsidies applied in a manner that results in circumvention of the United States' export subsidy commitments within the meaning of Article 10 of the *Agreement on Agriculture* and are therefore inconsistent with Article 8 of that Agreement. In addition, the United States submits that, although the Panel did not find that the United States had circumvented such commitments with respect to scheduled commodities other than rice, it nevertheless erred in concluding that the programs as applied to these scheduled agricultural products constitute export subsidies within the meaning of the *Agreement on Agriculture*.

65. The United States contends that the Panel erroneously analyzed whether export credit guarantees are export subsidies subject to the disciplines of Article 10.1 solely by reference to the *SCM Agreement*, ignoring important context in Article 10 of the *Agreement on Agriculture*. According to the United States, the proper context in which to analyze the meaning of Article 10.1 with respect to export credit guarantees is Article 10.2 of the *Agreement on Agriculture*, the only provision that explicitly addresses these specific kinds of measures. Article 10.2 reflects the fact that, during the Uruguay Round, WTO Members did not agree on disciplines applicable to agricultural export credits, export credit guarantees, or insurance programs. Unable to reach agreement on such disciplines within the Uruguay Round, WTO Members opted to continue discussions, deferring the imposition of substantive disciplines until a consensus was achieved.

66. According to the United States, this interpretation of Article 10.2 is consistent with Article 10 as a whole. Article 10.2 contributes to the prevention of circumvention of export subsidy commitments by imposing two obligations on Members: first, they must undertake to work toward the development of internationally agreed disciplines on export credit guarantees; and, second, "after agreement on such disciplines", they must provide export credit guarantees "only in conformity

therewith".<sup>62</sup> Moreover, excluding export credit guarantees from the application of Article 10.1 is consistent with the treatment of food aid transactions under Article 10. Because Article 10.4 of the *Agreement on Agriculture* does not explicitly exempt food aid transactions from the applicability of Article 10.1, the Panel's interpretative approach would mean that all food aid transactions constitute export subsidies under Article 10.1.

67. The United States submits that the negotiating history confirms its interpretation that Article 10.2 excludes export credit guarantees from the export subsidy disciplines in Article 10.1. The negotiating history reflects that WTO Members initially included export credit guarantees as a subject for negotiation but later specifically elected not to include those practices as exports subsidies in respect of goods covered by the *Agreement on Agriculture*. The Panel's explanation that the negotiators deleted the language on export credits from a 1991 draft of Article 9 because it was "mere surplusage"<sup>63</sup> is inconsistent with the fact that other practices included in the Illustrative List of Export Subsidies of the *SCM Agreement* were also listed in Article 9.1 of the *Agreement on Agriculture*, such as direct subsidies contingent upon export performance, or transport and freight charges provided at more favourable rates.

68. The United States argues that reliance on the negotiating history in this case is appropriate, under Article 32 of the *Vienna Convention on the Law of Treaties* (the "*Vienna Convention*"<sup>64</sup>), because the Panel's interpretation leads to a manifestly unreasonable result. Had export credit guarantees remained in Article 9, then the United States and other providers of export credit guarantees would have been expressly permitted to include such measures in their respective export subsidy reduction commitments. In the absence of a reference in Article 9, the United States was foreclosed from including them. It defies logic, as well as the object and purpose of the *Agreement on Agriculture*, to take the view of the Panel whereby such measures would be treated as already disciplined export subsidies, yet such measures would not be permitted to be included within the applicable reduction commitments expressly contemplated by the text.

69. The United States also requests that the Appellate Body reverse the Panel's finding that export credit guarantees for agricultural commodities are subject to Articles 3.1 and 3.2 of the *SCM Agreement*. The United States explains that export credit guarantees are not listed in Article 9.1 of the *Agreement on Agriculture* and are exempt, through the operation of Article 10.2, from the export subsidy disciplines in Article 10.1. Because export credit guarantees are not subject to export subsidy disciplines under the *Agreement on Agriculture*, the export subsidy disciplines of the

<sup>62</sup>Quoting from Article 10.2 of the *Agreement on Agriculture*.

<sup>63</sup>United States' appellant's submission, para. 379 (quoting Panel Report, para. 7.940).

<sup>64</sup>Done at Vienna, 23 May 1969, 1155 U.N.T.S. 331; 8 International Legal Materials 679.

*SCM Agreement* are also inapplicable to these measures pursuant to Article 21.1 of the *Agreement on Agriculture* and the introductory language of Article 3.1 of the *SCM Agreement*.

(iv) *Burden of proof*

70. The United States submits that the Panel erred in three different ways in respect of the application of the burden of proof in assessing the United States' export credit guarantee programs under item (j) of the Illustrative List of Export Subsidies annexed to the *SCM Agreement*.

71. First, the United States asserts that the Panel erred by applying the "special rules" on burden of proof provided in Article 10.3 of the *Agreement on Agriculture* in its examination of Brazil's claim under the *SCM Agreement*. The United States argues that the special rules in Article 10.3 of the *Agreement on Agriculture* do not apply in the context of the *SCM Agreement*.

72. In addition, the United States submits that the Panel erred by applying the special rules on burden of proof in Article 10.3 of the *Agreement on Agriculture* in examining whether the United States circumvented its export subsidy commitments with respect to upland cotton and certain other *unscheduled* agricultural products. According to the United States, Article 10.3 does not apply at all in respect of export subsidies to an agricultural good for which the respondent has no reduction commitments.

73. Finally, the United States refers to three specific instances in which the Panel allegedly erred in applying the burden of proof. The first example is the Panel's statement that the premiums charged by the Commodity Credit Corporation (the "CCC") for the export credit guarantees "are not geared toward *ensuring* adequacy to cover long-term operating costs and losses for the purposes of item (j)".<sup>65</sup> The United States asserts that this is a much higher threshold than that provided in the text of item (j) of the Illustrative List of Export Subsidies annexed to the *SCM Agreement*. Next, the United States takes issue with the Panel's statements that "[i]n terms of the structure, design and operation of the ... programmes [we] believe that the programmes are not designed to avoid a net cost to government"<sup>66</sup> and that the Panel was entitled to inquire whether revenue "would be likely to cover the total of all operating costs and losses under the programme".<sup>67</sup> According to the United States, "[t]o 'avoid a net cost' prospectively is simply not the requirement of item (j)", and the "likelihood"

<sup>65</sup>United States' appellant's submission, para. 406 (quoting Panel Report, para. 7.859). (emphasis added by the United States)

<sup>66</sup>*Ibid.*, para. 407 (quoting Panel Report, para. 7.857).

<sup>67</sup>*Ibid.*, para. 407 (quoting Panel Report, para. 7.805).

standard of performance" imposed by the Panel is higher than that found in item (j).<sup>68</sup> The third example cited by the United States is the Panel's statement that "[w]e have not been persuaded that cohort re-estimates over time, will *necessarily* not give rise to a net cost to the United States government."<sup>69</sup> The United States contends, however, that under the applicable burden of proof it is not for the United States to make such incontrovertible demonstrations to the Panel.

(v) *Necessary findings of fact*

74. The United States asserts that the Panel erred by failing to make certain factual findings that were necessary for the Panel's analysis of whether premiums are adequate to cover the long-term costs and losses of the United States' export credit guarantee programs, under item (j) of the Illustrative List of Export Subsidies. According to the United States, the Panel made no findings "on the basis for and monetary extent to which the United States has allegedly not covered its long-term operating costs and losses for the CCC export credit guarantee programs".<sup>70</sup>

75. In particular, the United States asserts that the Panel should have made a specific finding on the treatment of rescheduled debt. The United States explains that the Panel did not conclude that rescheduled debt was an operating cost or loss. Instead, the Panel "stated only vaguely" that it shared Brazil's concern that the United States' treatment of rescheduled debt understates the net cost to the United States government associated with the export credit guarantee programs.<sup>71</sup>

76. The United States argues that the Panel's failure to make these factual findings compels the reversal of the Panel's determination in respect of item (j) of the Illustrative List of Export Subsidies.

B. *Arguments of Brazil – Appellee*

1. Domestic Support

(a) Terms of Reference – Expired Measures

77. Brazil submits that the Appellate Body should reject the United States' request to reverse the Panel's finding that expired production flexibility contract and market loss assistance payments were

<sup>68</sup>United States' appellant's submission, para. 407.

<sup>69</sup>*Ibid.*, para. 408 (quoting Panel Report, para. 7.853). (emphasis added by the United States) In the same paragraph, the United States mentions the following statement by the Panel: "[w]hile there may be a possibility (based on the experience of certain of other cohorts) that this figure may diminish over the lifetime of the cohort concerned, there is no assurance that this figure will *necessarily* evolve towards, and conclude as, zero or a negative figure." (Panel Report, footnote 1028 to para. 7.853) (emphasis added by the United States)

<sup>70</sup>United States' appellant's submission, para. 419.

<sup>71</sup>*Ibid.*, para. 416.

outside the Panel's terms of reference. Brazil argues that neither Article 4.2 nor Article 6.2 of the DSU precludes a panel from analyzing payments made in the past in the context of serious prejudice claims. Brazil focuses on the context provided by Article 3.3 of the DSU, which states that a purpose of dispute settlement is the "prompt settlement of situations in which a Member considers that any benefits accruing to it ... are being impaired by measures taken by another Member". For Brazil, as long as the impairment is current, then the status in domestic law of the measure causing impairment is irrelevant.

78. Brazil notes that the current case involves allegations of "adverse effects" and "serious prejudice" under the provisions of the *SCM Agreement* and the GATT 1994. A breach of these provisions does not necessarily arise when an actionable subsidy is granted, but only when adverse effects occur, and the breach continues for the entire period during which the adverse effects continue. The effects of an actionable subsidy, which "affect[] the operation of" the *SCM Agreement* in the sense of Article 4.2 of the DSU, may well linger even after the measure providing for the subsidy expires. There is thus no basis for the United States' claim that the subsidies in question "cannot" be measures affecting the operation of any covered agreement. In particular, there is no justification in this context for the distinction, drawn by the United States, between recurring and non-recurring subsidies. The inquiry as to whether a subsidy continues to cause adverse effects beyond the year in which it was granted is a substantive judgment, and cannot be treated as a "jurisdictional hurdle".<sup>72</sup> Brazil finds support for its position in the view of the panel in *Indonesia – Autos*, which found that past, present, and future subsidies can be the subject of dispute settlement, as the effect of such measures may cause serious prejudice to the interests of a Member.

79. Brazil also disputes the United States' claims regarding Article 12.7 of the DSU. In Brazil's view, the Panel fulfilled the requirements of Article 12.7 in its Report. Many of the United States' claims under Article 12.7 are, in reality, allegations of error concerning the Panel's exercise of its discretion under Article 11 of the DSU and should be dismissed for want of specification of a claim under that provision.

(b) Article 13(a) of the *Agreement on Agriculture – Planting Flexibility Limitations*

80. Brazil considers that production flexibility contract and direct payment programs are not green box measures falling under Annex 2 of the *Agreement on Agriculture* and are thus not exempt from actions pursuant to Article 13(a) of that Agreement. Brazil requests the Appellate Body to

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<sup>72</sup>Brazil's appellee's submission, para. 255.

uphold the Panel's finding, under paragraph 6(b) of Annex 2, that production flexibility contract payments under the FAIR Act of 1996<sup>73</sup> and direct payments under the FSRI Act of 2002 relate the amount of the payment to the type of production undertaken by recipients because these payments are made solely if a producer grows crops other than fruits and vegetables (and, in the case of direct payments, wild rice as well).

81. Brazil relies upon the Panel's finding that paragraph 6(b) of Annex 2 addresses both positive requirements that certain products be produced and negative requirements that certain products not be produced. Brazil submits that the Panel correctly held that the words "related to," in paragraph 6(b) of Annex 2, preclude the establishment of any kind of relationship between the amount of a payment and the type of production undertaken. Accordingly, the text requires that the amount of a decoupled payment not be affected, influenced, or dependent, in any way, upon the type of crop planted. Brazil contends that the United States inappropriately seeks to read into paragraph 6(b) an exception for planting restrictions. Brazil observes that where the drafters intended to provide such an exception, they did so explicitly, as is evidenced by paragraphs 11(b) and 11(e) of Annex 2. For Brazil, Annex 2 cannot simply be reduced to the proposition that a measure is exempt if it is consistent with the fundamental requirement established in paragraph 1 that such measures have no, or at most minimal, trade-distorting effects or effects on production. Such an interpretation would overlook the policy-specific criteria in the other paragraphs of Annex 2.

82. Brazil nevertheless agrees with the United States that the expression in paragraph 6(b) "related to ... the type ... of production" does not preclude a Member from making decoupled payments conditional upon producers undertaking no production at all. Brazil highlights, however, that a total ban on production is different from a partial ban, because payment is conditional upon the planting of certain crops as opposed to others. The Panel's factual findings support this view: the Panel found that the planting flexibility limitations impose a "significant constraint" on production decisions.<sup>74</sup> Brazil argues that, under the production flexibility contract and direct payment measures, the amount of payment is always "related to" the type of production undertaken. If permitted crop "types" are produced exclusively, a full payment is made. If a small quantity of "prohibited" crops is produced, the amount of payment is reduced. If a larger quantity of prohibited crops is produced, no payment is made.

83. Furthermore, the various findings by the Panel contradict the United States' basic assertion that "a condition that a recipient not produce certain products serves the fundamental requirement of

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<sup>73</sup>Federal Agriculture Improvement and Reform Act of 1996 (the "FAIR Act of 1996"); Public Law 104-127.

<sup>74</sup>Brazil's appellee's submission, para. 287 (quoting Panel Report, para. 7.386).

Annex 2, that measures have no more than minimal trade-distorting effects and effects on production."<sup>75</sup> Rather, a partial prohibition creates incentives for the production of certain crops, and disincentives for the production of prohibited crops. In essence, the Panel found that planting flexibility limitations *did* channel production away from fruits, vegetables (and wild rice) and towards other commodities, such as upland cotton. Brazil thus disputes the distinction put forward by the United States between measures that make payment contingent upon the production of "permitted" crops and those that make payment contingent upon the non-production of "prohibited" crops. As the Panel found on the facts of this case, their effects are the same. The Panel found that "the planting flexibility limitations provide a monetary incentive for payment recipients not to produce the prohibited crops"<sup>76</sup>, and that production flexibility contract payments and direct payments have positive production effects by restricting production choices and keeping land dedicated to the production of the permitted crops. Thus, providing income support, whilst also excluding income support when certain types of crop are produced, relates the amount of the income support to the type of production undertaken within the meaning of paragraph 6(b).

84. Finally, Brazil takes issue with the United States' assertion that the Panel's interpretation would require a Member to make decoupled income support payments even if the recipient produced illegal crops or crops damaging to the environment. There was no basis for the Panel to address this issue because the planting flexibility limitations at issue do not pertain to the production of illegal or environmentally-damaging crops. In any event, nothing in the *Agreement on Agriculture* suggests that the word "production" means anything other than *lawful* production. The Panel properly declined to consider the hypothetical situations not created by the United States' measures at issue in the dispute.

(c) Article 13(b) of the *Agreement on Agriculture*

85. Brazil submits that the United States' non-green box domestic support measures are not exempt from actions by virtue of Article 13(b)(ii) of the *Agreement on Agriculture*, and asks the Appellate Body to uphold the Panel's finding that the United States granted implementation period support to upland cotton in excess of that decided in the 1992 marketing year, within the meaning of that provision. Brazil argues that the Panel's interpretation of Article 13(b)(ii) was consistent with its ordinary meaning, context and object and purpose, and that the methodological choices made by the Panel in undertaking the comparison required by Article 13(b)(ii) were reasonable and within the bounds of its discretion as the trier of fact.

<sup>75</sup>Brazil's appellee's submission, para. 291 (quoting the United States' appellant's submission, para. 22).

<sup>76</sup>*Ibid.*, para. 320 (quoting Panel Report, para. 7.386).

(i) *Interpretation of "support to a specific commodity"*

86. Brazil contends that the Panel correctly interpreted the phrase "support to a specific commodity" in Article 13(b)(i) of the *Agreement on Agriculture* to mean "all non-green box support measures that clearly or explicitly define a commodity as one to which they bestow or confer support".<sup>77</sup> This includes crop insurance and the three subsidies described by the United States as "product-specific" domestic support (marketing loan program payments, Step 2 payments, and cottonseed payments), as well as the four measures characterized by the United States as "decoupled" payments (production flexibility contract payments, direct payments, market loss assistance, and counter-cyclical payments).

87. Brazil submits that the United States' interpretation of the phrase "support to a specific commodity" in Article 13(b)(i) of the *Agreement on Agriculture* is that support falling within the proviso to Article 13(b)(ii) must require production of only one specific crop. Brazil observes that this argument was rejected by the Panel, which concluded that nothing in the text of Article 13(b)(ii) suggests that relevant measures must provide support only to a single commodity, and noted that a single measure could provide support to multiple specific commodities. Brazil agrees with the Panel that "[i]f a measure specifies more than one commodity, it would be appropriate to measure the amount of support granted to each of them in accordance with the terms of the measure itself."<sup>78</sup> The practical effect of the extremely narrow United States reading of Article 13(b)(ii) is to erase US \$4.2 billion in production flexibility contract payments, direct payments, market loss assistance, and counter-cyclical payments to recipients who actually grew upland cotton in the 1999-2002 marketing years, even though these four subsidies covered a significant portion of upland cotton producers' costs of production during this period. Brazil contends that the crucial conclusion drawn by the Panel from this data was a clear linkage between historic upland cotton producers and present upland cotton producers. The Panel found that "the overwhelming majority of farms enrolled in the programmes which plant upland cotton also hold upland cotton base", specifically, 96.1 per cent in the 2002 marketing year.<sup>79</sup> For Brazil, the evidence on record and the Panel's findings contradict the United States' factual assertions that there is no connection between current payments under the production flexibility contract, direct payment, market loss assistance, and counter-cyclical payment programs on the one hand, and current upland cotton production on the other.

88. Brazil agrees with the Panel's conclusion that the deliberate decision of the drafters *not* to use in Article 13(b)(i) readily available terms, such as "product-specific" and "non-product-specific"

<sup>77</sup>Brazil's appellee's submission, para. 358 (quoting Panel Report, para. 7.494).

<sup>78</sup>*Ibid.*, para. 371 (quoting Panel Report, para. 7.483).

<sup>79</sup>*Ibid.*, para. 383 (quoting Panel Report, para. 7.636).

(and the definitions in Articles I(a) and (h) of the *Agreement on Agriculture*) means that the drafters intended the term "support to a specific commodity" to have a unique meaning. The Panel properly found that this unique phrase does not mean "product-specific domestic support" because "the class of measures which is covered by paragraph (b) [of Article 13] is broader than either" that term or the phrase "support ... provided for an agricultural product in favour of the producers".<sup>80</sup> The Panel correctly focused on the fact that the term "support to a specific commodity" in Article 13(b)(ii) refers to *all* measures set out in the chapeau to Article 13(b). There was therefore no basis in the text to limit the measures covered by Article 13(b)(ii) solely to measures requiring production of a single commodity. Brazil adds that such an interpretation would be contrary to the object and purpose of the *Agreement on Agriculture*, creating a new category of trade-distorting domestic support that would evade the limits set by the Members for exempting domestic support measures from actions under the *SCM Agreement* and the GATT 1994. Under the United States' interpretation, as long as measures do not require production of a *single* commodity, they would *never* be counted as implementation period support for purposes of the peace clause comparison, effectively insulating such measures from serious prejudice actions.

89. In addressing the manner in which the value of support under the production flexibility contract, market loss assistance, direct payment, and counter-cyclical payment programs should be calculated, Brazil submits that the Appellate Body should be wary of setting the evidentiary bar too high for complaining Members seeking to demonstrate precise amounts of support to a specific commodity for purposes of Article 13(b)(ii). Brazil contends that the Appellate Body should affirm the Panel's use of the total budgetary outlays to upland cotton base acres. Brazil observes, however, that the Panel endorsed in the "Attachment to Section VII:D" two other approaches for allocating implementation period support under these programs to upland cotton: the "cotton-to-cotton" methodology and "Brazil's methodology". Brazil maintains that, under any of these approaches, the United States granted support to upland cotton in the years 1999, 2000, 2001, and 2002 in excess of that decided during the 1992 marketing year.

(ii) *Calculation methodology for price-based measures*

90. In addressing the United States' arguments regarding the appropriate methodology for calculating the value of certain United States price-based measures (the marketing loan program payments and deficiency payments), Brazil agrees with the Panel that "the use of the verb 'decided' stands in contrast to the use of the verb 'grant' in relation to the same noun 'support' in the same

proviso."<sup>81</sup> The Panel found that "despite the contrast, the proviso calls for a comparison which necessarily requires the two halves of the comparison to be expressed in the same units of measurement."<sup>82</sup> The Panel further noted that "[a] difference between the support that a government decides and the support that its measures grant is that one is expressed in terms of prior determinations of levels of support and the other in terms of subsequent support provided."<sup>83</sup> The Panel concluded by stating that "[d]ecided" refers to what the government determines, but 'grant' refers to what its measures provide."<sup>84</sup> Brazil submits that the Panel's explanation and reasoning for its interpretation are consistent with the ordinary meaning of the term in its context, and are supported by the Appellate Body's decision in *Brazil – Aircraft*.

91. Brazil contends that the United States incorrectly implies that the Panel agreed with the United States that the peace clause proviso "compares the support a Member determines through its measures, not 'support [that] was spent due to reasons beyond the control of the government'".<sup>85</sup> Brazil argues that the Panel explicitly rejected this contention and concluded that "the text indicates that implementation period support must be measured in terms of support that measures 'grant', rather than what was budgeted or *estimated*."<sup>86</sup>

92. Against this background, Brazil argues that the plain text of paragraph 10 of Annex 3 to the *Agreement on Agriculture* permits the use of *either* a budgetary outlay *or* a price gap methodology for calculating the value of price-based payments. There is no textual basis for concluding, for purposes of the peace clause, that only price gap methodology may be used. Brazil also notes the Panel's factual finding that the United States adopted a budgetary outlay methodology in accounting for marketing loan program payments in its AMS notifications. Brazil observes that when the United States agreed with other WTO Members on its base level AMS, the United States chose to calculate marketing loan program payments using a budgetary outlay methodology. Brazil argues that the United States' decision to use budgetary outlays instead of price gap methodology for notifying the value of marketing loan program payments is legally binding on the United States. This conclusion follows from the text of Articles 6.3 and 3.2 of the *Agreement on Agriculture*. Nothing in Article 6 or any other provision of the *Agreement on Agriculture* permits a Member to change the methodology

<sup>81</sup>Brazil's appellee's submission, para. 340 (quoting Panel Report, para. 7.435).

<sup>82</sup>Panel Report, para. 7.435.

<sup>83</sup>*Ibid.*, para. 7.436.

<sup>84</sup>*Ibid.*, para. 7.476.

<sup>85</sup>Brazil's appellee's submission, para. 346 (quoting the United States' appellant's submission, para. 66).

<sup>86</sup>*Ibid.*, para. 346 (quoting Panel Report, para. 7.557). (emphasis added by Brazil)

used to calculate the value of price-based measures, once that methodology has been used in AMS notifications.

93. Brazil also notes that, although the Panel primarily relied on a budgetary outlay methodology, it also made alternative factual findings regarding the use of price gap methodology for the calculation of marketing loan program payments in the implementation period and for the 1992 benchmark period, as well as for deficiency payments in the 1992 benchmark period only. Brazil highlights the Panel's finding that under *either* approach the United States grants support to upland cotton in excess of that decided in the 1992 marketing year; the Panel found that "both methodologies lead to the same result."<sup>87</sup> As a result, even if the legal grounds for the United States' appeal were valid, the facts on record would require the Appellate Body to uphold the Panel's conclusions that the United States granted support in each of the 1999-2002 marketing years that exceeded the "support decided during the 1992 marketing year".

## 2. Serious Prejudice

### (a) Significant Price Suppression under Article 6.3(c) of the *SCM Agreement*

94. Brazil submits that the Panel properly found that the effect of the price-contingent subsidies is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement* constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*. Brazil asks the Appellate Body to uphold this finding, and to find that the Panel set out the findings of fact, the applicability of relevant provisions, and the basic rationale behind this finding, as required by Article 12.7 of the DSU. Brazil argues that many of the United States' arguments<sup>88</sup>, and particularly those concerning serious prejudice, involve allegations that the Panel failed to "make an objective assessment of the matter before it, including an objective assessment of the facts of the case" pursuant to Article 11 of the DSU. Brazil requests the Appellate Body to ignore these arguments because the United States has not made a proper claim of error under Article 11 of the DSU.

95. First, in response to the United States' argument that the market in which a panel assesses significant price suppression under Article 6.3(c) cannot be a "world market", Brazil maintains that the subsidized and like products must be present in the market examined. Brazil submits that the ordinary meaning of the text of Article 6.3(c) of the *SCM Agreement* indicates that this provision

<sup>87</sup>Panel Report, para. 7.555.

<sup>88</sup>Brazil lists the relevant arguments in Annex A of its appellee's submission.

"may apply to *any* 'market,' from local to global, and everything in between".<sup>89</sup> This contrasts with paragraphs (a), (b), and (d) of Article 6.3, which expressly qualify the type of market at issue. It is also consistent with the object and purpose of the *Marrakesh Agreement Establishing the World Trade Organization* (the "*WTO Agreement*") (which addresses barriers to "world trade") and the *Agreement on Agriculture* (which addresses "world agricultural markets").<sup>90</sup> Brazil maintains that the Panel found, as a matter of fact, that a world market exists for upland cotton.<sup>91</sup> In addition, contrary to the assertion of the United States, Brazil contends that the Panel did find that United States and Brazilian cotton are present in the world market.<sup>92</sup> However, Brazil agrees with the Panel that the existence of a world market does not preclude the possibility of other markets, and that a world market does not necessarily exist for all products. Brazil refutes the United States' suggestion that the Panel did not find that *Brazilian* prices in the world market for upland cotton were significantly suppressed.<sup>93</sup> In Brazil's view, the Panel found that "Brazilian prices, *i.e.*, prices in Brazil and prices received for Brazilian exports, are significantly suppressed".<sup>94</sup>

96. Secondly, in relation to the United States' allegation that the Panel used circular reasoning to find "significant price suppression", Brazil emphasizes that several factors relate to both the "effect of the subsidy" and "significant price suppression", and the Panel gave separate explanations of these factors in terms of the "effect" and the "suppression". Brazil states that the Panel did take into account supply responses from third countries that would flow from removal of the price-contingent subsidies, in taking into account econometric models that incorporated such supply responses.<sup>95</sup> Brazil also states that the Panel examined the ordinary meaning of the word "significant", properly concluded that it is the degree of price suppression that matters rather than the degree of significance, and provided substantial reasons for its conclusion that the degree of price suppression it had found in the present dispute was significant.

97. Thirdly, in relation to the United States' challenge to the Panel's finding of the "effect" of the price-contingent subsidies, Brazil points out that the Panel did examine the United States' arguments regarding the "farmer's planting decision" and the responsiveness of United States producers to price

<sup>89</sup>Brazil's appellee's submission, para. 628. (original emphasis)

<sup>90</sup>*Ibid.*, para. 633. (emphasis omitted)

<sup>91</sup>*Ibid.*, paras. 619 and 622 (referring to Panel Report, paras. 7.1274 and 7.1311).

<sup>92</sup>*Ibid.*, paras. 644 and 808 (referring to Panel Report, paras. 7.1266, 7.1282-7.1284 and 7.1313).

<sup>93</sup>*Ibid.*, paras. 799-801 (referring to Panel Report, paras. 7.1311 and 7.1313).

<sup>94</sup>*Ibid.*, para. 802.

<sup>95</sup>*Ibid.*, paras. 793-798 (referring to Panel Report, paras. 7.1205, 7.1209, and 7.1215).

signals.<sup>96</sup> Brazil explains that United States upland cotton farmers base planting decisions on expected net returns, meaning expected market prices together with expected government support. According to Brazil, the record contains ample evidence to support the Panel's view that the United States exercises a significant influence on the world market price for upland cotton. Even if movements in planted upland cotton acreage of United States producers correspond with those of other producers (which Brazil disputes), this would not detract from the Panel's finding that the overall level of upland cotton production by United States producers would be significantly lower in the absence of the price-contingent subsidies. The Panel properly assessed the nature of the price-contingent subsidies and properly found a temporal coincidence between those payments and suppressed upland cotton prices, based not merely on the end points of the 1998-2001 marketing year period, but on more detailed data. Finally, Brazil maintains that the Panel properly found that United States upland cotton producers were able to continue to produce upland cotton by virtue of the price-contingent subsidies. Although variable costs may be most relevant in the short term, the Panel found that upland cotton producers must cover their total costs of production in the mid- to long-term. According to Brazil, the fact that United States producers might have been able to cover the costs of upland cotton production through other agricultural production as well as "off-farm income"<sup>97</sup> is irrelevant to the question of the effect of the price-contingent subsidies on the United States industry producing upland cotton.

98. Fourthly, in response to the United States' arguments regarding the quantification of subsidies, Brazil states that neither the text nor the context of Articles 5(c) and 6.3 of the *SCM Agreement* imposes a "preliminary requirement to quantify exactly the amount of each subsidy prior to examining whether it causes adverse effects".<sup>98</sup> Brazil supports its interpretation by reference to Article 6.1(a) and Annex IV of the *SCM Agreement*, which, unlike Article 6.3, impose quantification methodologies. Brazil also distinguishes the analysis required under Part III of the *SCM Agreement* from that required under Part V of that Agreement. Under Part V, it is necessary to calculate the exact amount of subsidization in order to avoid imposing excess countervailing duties. However, the remedy under Part III focuses on the effects of the subsidy, rather than the imposition of duties, and, according to Brazil, the size of a subsidy does not necessarily determine its effects. Finally, Brazil contests the United States' reliance on Annex V of the *SCM Agreement*. In Brazil's view, Annex V sets out procedures for the collection of information and does not require the Panel to

<sup>96</sup>Brazil's appellee's submission, para. 168 (referring to the United States' appellant's submission, para. 324).

<sup>97</sup>*Ibid.*, para. 788 (referring to the United States' appellant's submission, para. 224).

<sup>98</sup>*Ibid.*, para. 467.

use such information, and the references to an "amount" in paragraphs 2 and 5 of Annex V are directed towards Article 6.1(a) rather than Article 6.3 of the *SCM Agreement*.

99. In response to the United States' arguments regarding the allocation of counter-cyclical payments and market loss assistance payments to upland cotton, Brazil argues that the methodology in Annex IV of the *SCM Agreement* applies only to Article 6.1 and not to Article 6.3(c), and that Annex IV has now expired. In any case, the Panel did find a "strongly positive relationship" between those payments and the production of upland cotton.<sup>99</sup>

100. Brazil contends that the United States' arguments distinguishing between "raw" and "processed" cotton improperly raise new factual and legal issues not before the Panel, including a suggestion that raw cotton is a product distinct from processed cotton. Brazil submits that the Panel found, and the parties agreed, that upland cotton lint is the only subsidized product at issue in this dispute. Moreover, according to Brazil, the Panel found that all price-contingent subsidies benefited the subsidized product (upland cotton), regardless of the stage at which they were provided. Brazil rejects the United States' reliance on the Appellate Body Report in *US – Softwood Lumber IV*.

101. Finally, Brazil responds to the United States' arguments as to the allocation of recurring subsidies to a particular year as follows. Articles 5(c) and 6.3 of the *SCM Agreement* do not explicitly exempt consideration of effects of annually recurring subsidies beyond the year in which they are paid. Furthermore, the United States' interpretation would create a new category of non-actionable subsidies. For example, according to Brazil, the United States' argument would exclude all the subsidies challenged by Brazil because they would be deemed to have no effects after 1 August 2003, well before the Panel circulated its Report. The possibility of making an "as such" claim against the subsidy programs as a whole would provide little comfort because these types of claims can be difficult to prove. Brazil also suggests that "WTO Members provide agricultural subsidies largely on a 'recurring' annual basis"<sup>100</sup> and, therefore, one would have expected an explicit exclusion of such subsidies from the disciplines of particularly Part III of the *SCM Agreement* and the *Agreement on Agriculture* if this were the intention of the drafters. The United States' contrary assertion improperly excludes the possibility for Members to seek the removal of adverse effects of any subsidies (whether recurring or otherwise), as reflected in Article 7.8 of the *SCM Agreement*.

102. In relation to the findings that the Panel made regarding the subsidies at issue in this dispute, Brazil challenges the United States' contention that the Panel made no findings regarding the effects in marketing year 2002 of subsidies paid in marketing years 1999 to 2001. The Panel explained its

<sup>99</sup>Brazil's appellee's submission, para. 523 (quoting Panel Report, para. 7.1226).

<sup>100</sup>*Ibid.*, para. 559.

decision to examine serious prejudice over a period including marketing year 2002, and its findings indicate that it regarded the effects of certain subsidies as continuing in that year. In addition, Brazil submits that no "bright lines"<sup>101</sup> can be drawn between upland cotton subsidies paid in different marketing years, because the marketing year runs from 1 August to 31 July, and upland cotton is planted in one marketing year and harvested in the next.

3. Import Substitution Subsidies and Export Subsidies

(a) Step 2 Payments

(i) *To domestic users*

103. Brazil requests that the Appellate Body uphold the Panel's conclusion that Step 2 payments to domestic users of United States upland cotton, provided under Section 1207(a) of the FSRI Act of 2002, are inconsistent with Articles 3.1(b) and 3.2 of the *SCM Agreement*. Brazil submits that the Panel correctly held that the *Agreement on Agriculture* and the *SCM Agreement* apply cumulatively, unless there is an exception or a conflict. Such an exception must be explicitly stated.<sup>102</sup> According to Brazil, in *EC – Bananas III*, the Appellate Body found that the *Agreement on Agriculture* permits inconsistencies with obligations in other covered agreements solely if this is "explicitly" stated in the text.<sup>103</sup> Similarly, an explicit exception would be required for the *Agreement on Agriculture* to exempt certain measures from the prohibition in Article 3.1(b) of the *SCM Agreement*.

104. Brazil contends that no such exception is provided in the *Agreement on Agriculture* or in the *SCM Agreement*. The introductory phrase in Article 3.1 of the *SCM Agreement* ("[e]xcept as provided in the Agreement on Agriculture") does not mean that Article 3.1 does not apply to domestic support measures conforming to the *Agreement on Agriculture*; instead, it confirms that Article 3.1 of the *SCM Agreement* applies unless it conflicts with specific provisions of the *Agreement on Agriculture*. This interpretation is confirmed by Article 21.1 of the *Agreement on Agriculture* and by the absence of any exception in Article 13 of the *Agreement on Agriculture* regarding Article 3.1(b).

105. Brazil asserts that, under the *Agreement on Agriculture*, WTO Members are entitled to grant domestic support in favour of agricultural producers. However, this does not create a conflict with Article 3.1(b) of the *SCM Agreement*, because it is perfectly possible for Members to grant domestic

<sup>101</sup> Brazil's appellee's submission, para. 570.

<sup>102</sup> *Ibid.*, para. 832 (referring to Appellate Body Report, *US – Cotton Yarn*, para. 120).

<sup>103</sup> *Ibid.*, para. 833 (referring to Appellate Body Report, *EC – Bananas III*, para. 157).

support without making payments contingent on domestic content. In other words, Members can fully enjoy their right to grant domestic support and still comply with Article 3.1(b) of the *SCM Agreement*. This interpretation is consistent with a primary objective of the WTO agreements, namely, avoiding discrimination under the national treatment rule. It is also consistent with an adopted GATT panel report regarding a domestic support measure to agricultural producers that was contingent on the purchase of domestic goods. That panel recognized that the GATT contracting parties were entitled to grant support to agricultural producers but found that this could be done without granting domestic content subsidies.<sup>104</sup> The panel held that a domestic content subsidy in favour of agricultural producers was inconsistent with Article III:4 of the GATT 1947. Therefore, Brazil contends that domestic support under the *Agreement on Agriculture* can and must be granted consistently with Article 3.1(b) of the *SCM Agreement*.

(ii) *To exporters*

106. Brazil requests the Appellate Body to uphold the Panel's findings that Step 2 payments to exporters of United States upland cotton are contingent upon export performance and, consequently, are inconsistent with Articles 3.3 and 8 of the *Agreement on Agriculture* and are prohibited under Articles 3.1(a) and 3.2 of the *SCM Agreement*.

107. Brazil agrees with the Panel that the principles set out by the Appellate Body in *US – FSC (Article 21.5 – EC)* apply to Step 2 payments to exporters.<sup>105</sup> In one situation under the Step 2 measure, proof of exportation is required as a condition of payment. This export contingency is not dissolved because the payment can also be made in another situation, on other conditions.

108. Brazil adds that, contrary to the United States' argument on appeal, this is not a measure that establishes a single set of conditions applying to all upland cotton produced in the United States.<sup>106</sup> On its own terms, the measure does not apply to all United States production of upland cotton. Instead, the measure carves out of that overall production two classes of upland cotton that may, on certain conditions, receive subsidies. In so doing, the measure targets two well-defined classes of

<sup>104</sup> Brazil's appellee's submission, para. 860 (referring to GATT Panel Report, *Italy – Agricultural Machinery*, para. 16).

<sup>105</sup> *Ibid.*, paras. 881-884 (referring to Appellate Body Report, *US – FSC (Article 21.5 – EC)*, paras. 113 and 119 and Appellate Body Report, *Canada – Aircraft*, para. 179).

<sup>106</sup> *Ibid.*, para. 890 (referring to the United States' appellant's submission, para. 444).

recipients and does not address either all United States production of upland cotton, or all "uses" of United States upland cotton.

109. Brazil also takes issue with the United States' assertion that Step 2 payments are contingent on use and not exportation. According to Brazil, Step 2 payments are not contingent on "use" in any meaningful sense. The measure is indifferent as to whether, how or when the upland cotton is "used." The criterion is not "use", but simply "exportation". Provided that the upland cotton is "shipped" from the United States, it would not matter if the upland cotton were never used, for instance, because its quality deteriorated during shipping or even because the ship carrying it sank. A subsidy would still be paid because of "exportation" from the United States.

110. Finally, Brazil distinguishes the facts in the present dispute from those before the panel in *Canada – Dairy*. In that case, a single regulatory class applied to all Canadian production of milk destined for a particular end-use.<sup>107</sup> In contrast, in the present case, the measure under which Step 2 payments are made explicitly establishes two mutually exclusive regulatory categories that apply to some, but not all, United States production of upland cotton.

111. Brazil requests, therefore, that the Appellate Body reject the United States' appeal and uphold the Panel's finding that Step 2 payments to exporters of United States upland cotton are contingent upon export performance and, consequently, are inconsistent with Articles 3.3 and 8 of the *Agreement on Agriculture* and are prohibited under Articles 3.1(a) and 3.2 of the *SCM Agreement*.

- (b) Export Credit Guarantees
  - (i) *Panel's terms of reference*

112. Brazil asks the Appellate Body to uphold the Panel's conclusion that export credit guarantees to facilitate the export of United States agricultural commodities other than upland cotton were within the Panel's terms of reference.

113. Brazil asserts that the measures included in its request for consultations, as well as in its request for establishment of a panel, were the General Sales Manager 102 ("GSM 102") program, the General Sales Manager 103 ("GSM 103") program, and the Supplier Credit Guarantee Program (the "SCGP"). Under United States law, each of these measures applies to all eligible agricultural products. Adding a particular product or products to Brazil's request for establishment would not, therefore, have constituted the addition of *measures*. In any event, Brazil argues that its request for

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<sup>107</sup> Brazil's appellee's submission, paras. 894-899 (referring to Panel Report, *Canada – Dairy*, paras. 2.39 and 7.41).

consultations, in fact, identified the United States' export credit guarantee measures in connection with all eligible commodities, without any limitation to upland cotton.

114. Additionally, Brazil asserts that, irrespective of the measures identified in Brazil's request for consultations, the Panel found, as a matter of fact, that "consultations were held" on the export credit guarantee measures in connection with all eligible commodities, as required by Article 6.2 of the DSU.<sup>108</sup> Brazil explains that the Appellate Body has held that as long as consultations were held on a measure included in a request for establishment of a panel, that measure is properly within a panel's terms of reference, irrespective of whether the measure was included in the request for consultations.<sup>109</sup> This is consistent with the purpose of consultations, which is to offer Members the opportunity to engage in good faith discussions with a view to resolving a trade dispute. The process necessarily involves collecting information that will shape the substance and scope of the dispute, should consultations fail.

- (ii) *Statement of available evidence*

115. Brazil asks the Appellate Body to deny the United States' claim that the Panel erred in concluding that Brazil provided a statement of available evidence with respect to the United States' export credit guarantee programs as they relate to agricultural commodities other than upland cotton, as required by Article 4.2 of the *SCM Agreement*.

116. According to Brazil, its statement of available evidence not only identified the measures at issue—the export credit guarantee measures—but also indicated the characteristics of those measures that had led Brazil to suspect that they constituted export subsidies. Brazil argues that this is consistent with the Appellate Body's interpretation of the requirements of Article 4.2 of the *SCM Agreement*.<sup>110</sup> Specifically, Brazil's statement describes the failure of the United States' export credit guarantee programs to establish premium rates that cover long-term operating costs and losses, which are central elements in determining whether a program constitutes an export subsidy under item (j) of the Illustrative List of Export Subsidies included as Annex I to the *SCM Agreement*. Further, the Panel found that the documentary evidence cited by Brazil to support its preliminary view was a link to a United States government website with data showing that revenues for the export credit guarantee programs do not cover long-term operating costs and losses.<sup>111</sup> The evidence

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<sup>108</sup> Brazil's appellee's submission, para. 211 (quoting Panel Report, para. 7.61).

<sup>109</sup> *Ibid.*, para. 213 (referring to Appellate Body Report, *Brazil – Aircraft*, paras. 132-133).

<sup>110</sup> *Ibid.*, paras. 228-229 (referring to Appellate Body Report, *US – FSC*, para. 161).

<sup>111</sup> *Ibid.*, para. 226 (referring to Panel Report, paras. 7.92-7.93).

addressed the failure of the export credit guarantee programs to cover long-term operating costs and losses overall, rather than in connection with upland cotton alone.

117. Thus, Brazil asserts, its statement of available evidence meets the requirements of Article 4.2, by identifying the export credit guarantee programs, and providing and describing available evidence of the character of those measures as export subsidies, across all eligible commodities.

(iii) *Article 10.2 of the Agreement on Agriculture*

118. Brazil requests that the Appellate Body reject the United States' appeal of the Panel's finding that export credit guarantees are subject to the export subsidy disciplines in Article 10.1 of the *Agreement on Agriculture*.

119. Brazil asserts that subsidized export credit guarantees are covered by the general definition of "export subsidies" under Article 1(c) of the *Agreement on Agriculture*. These measures are, therefore, subject to Article 10.1 of the *Agreement on Agriculture*, unless an express exception is provided in Article 10.2. The text of Article 10.2 establishes two obligations, but does not provide an exception. It requires WTO Members to negotiate multilateral rules to regulate agricultural export credit measures specifically, and to apply those rules once they are agreed. The text of Article 10.2 may be contrasted with several other WTO provisions that also require negotiations, but that state explicitly that the existing disciplines do not apply in the meantime.<sup>112</sup> The inclusion of such exceptions in other provisions highlights the lack of an exception in Article 10.2.

120. Brazil argues that the Panel's interpretation is consistent with the context and object and purpose of Article 10.2. Each of the paragraphs in Article 10 pursues the aim of preventing circumvention of export subsidy commitments and, thereby, contributes to the purpose of the *Agreement on Agriculture* of establishing specific binding commitments on export competition. Article 10.1 does so by disciplining export subsidies not listed in Article 9.1, as well as non-commercial transactions. Article 10.3 does so by reversing the usual rules on the burden of proof where Members have exported products in excess of their quantity reduction commitment levels. Article 10.4 does so by providing specific disciplines on food aid that ensure it is used for legitimate purposes and not to circumvent export subsidy commitments. Therefore, Article 10.2 must be interpreted in a manner that ensures that it contributes to the purpose of preventing circumvention of commitments on export competition. The United States' interpretation of Article 10.2 would leave

<sup>112</sup>Brazil's appellee's submission, paras. 916-917 (referring to footnote 15 to Article 6.1(a) and footnote 24 to Article 8.2(a) of the *SCM Agreement*, and Article XIII of the *General Agreement on Trade in Services*).

Members free to grant unlimited export subsidies in the form of export credit guarantees and would permit wholesale circumvention of commitments.

121. Brazil takes issue with the United States' assertion that the Panel's interpretation is an "assault" on international food aid.<sup>113</sup> According to Brazil, food aid is subject to the specific disciplines in Article 10.4 of the *Agreement on Agriculture*, as well as the general disciplines in Article 10.1. Article 10.4 pursues the aim of preventing circumvention by ensuring that, consistently with the international regulation of food aid, such transactions do not result in "harmful interference" with trade.<sup>114</sup> Further, Article 10.4(a) adds to the disciplines by prohibiting food aid that is "tied" to or contingent upon "commercial exports" of agricultural products. This is not an "assault" on food aid; rather, it ensures that food aid is used for legitimate humanitarian purposes and not for illegitimate trade-distortion.

122. Brazil, moreover, disagrees with the conclusions drawn by the United States from the negotiating history of the *Agreement on Agriculture*. Brazil explains that the negotiating history confirms that export credit guarantees are, indeed, subject to Article 10.1. Members had known since 1960 that subsidized export credit guarantees were covered by the term "export subsidies". During the negotiations, Members repeatedly expressed the intention to subject these measures to export subsidy disciplines, and they never once expressed the intention to exclude them from such disciplines. In addition, Brazil rejects the United States' contention that the Panel's reading of Article 10.2 gives rise to a result that is "manifestly unreasonable".<sup>115</sup> At the close of the Uruguay Round, Members agreed that they would calculate their respective export subsidy commitment levels exclusively on the basis of the export subsidies listed in Article 9.1. They chose to leave out of that calculation the export subsidies in Article 10.1.<sup>116</sup> This is not an unjust implementation of the Uruguay Round, but the logical consequence of the bargain Members struck. Brazil emphasizes that the Panel's interpretation does not mean that Members cannot grant export credit guarantees. Instead, it means that *subsidized* export credit guarantees are subject to discipline as trade-distorting measures, and cannot be used to override export subsidy commitments.

<sup>113</sup>Brazil's appellee's submission, para. 940 (quoting the United States' appellant's submission, para. 350).

<sup>114</sup>*Ibid.*, para. 940 (quoting paragraph 3, FAO "Principles of Surplus Disposal and Consultative Obligations", and Article IX(d) of the Food Aid Convention).

<sup>115</sup>*Ibid.*, para. 926 (quoting the United States' appellant's submission, para. 384).

<sup>116</sup>*Ibid.*, para. 927.

123. Finally, Brazil asserts that, even if Article 10.2 were to exempt export credit guarantees for agricultural commodities from the disciplines in the *Agreement on Agriculture*, these measures would still be subject to Article 3 of the *SCM Agreement*.<sup>117</sup>

(iv) *Burden of proof*

124. Brazil submits that, even if correct, none of the United States' arguments in respect of the Panel's application of the burden of proof would lead to a reversal of the Panel's conclusion that the United States' export credit guarantee programs constitute export subsidies under the *Agreement on Agriculture* and the *SCM Agreement*. Irrespective of which party bore the burden of proof and the role of Article 10.3 of the *Agreement on Agriculture*, the Panel explicitly found that Brazil had established that the premiums charged under the United States' export credit guarantee programs were inadequate to cover long-term operating costs and losses for purposes of item (j) of the Illustrative List of Export Subsidies annexed to the *SCM Agreement*.<sup>118</sup> Having concluded that Brazil had successfully demonstrated that the United States' export credit guarantee programs constitute export subsidies under item (j) as context for the interpretation of the term "export subsidies" in Articles 10.1 and 8 of the *Agreement on Agriculture*, the Panel similarly concluded that the export credit guarantee programs constitute prohibited export subsidies under item (j) of the Illustrative List of Export Subsidies and Articles 3.1(a) and 3.2 of the *SCM Agreement*.<sup>119</sup>

125. Brazil also takes issue with the United States' assertion that the Panel required the United States to offer "incontrovertible demonstrations to the Panel" that, under the net present value accounting methodology, data trends indicated profits for the programs.<sup>120</sup> Brazil explains that, as the party asserting that these trends existed, the United States bore the burden of proving their existence. In the statement challenged by the United States, the Panel simply found that the United States had not met this burden. The Panel made this finding based on data submitted by the United States. Given that the United States has not alleged that the Panel failed to make an objective assessment of the facts under Article 11 of the DSU, Brazil argues that the United States' appeal should be denied on these grounds alone.

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<sup>117</sup> At the oral hearing, however, Brazil clarified that if Article 10.2 were to exempt export credit guarantees for agricultural commodities from the disciplines in the *Agreement on Agriculture*, Article 3 of the *SCM Agreement* would not be applicable to such measures.

<sup>118</sup> Brazil's appellee's submission, paras. 1023-1024 (referring to Panel Report, para. 7.867).

<sup>119</sup> *Ibid.*, para. 1024 (referring to Panel Report, paras. 7.946-7.948).

<sup>120</sup> *Ibid.*, para. 1025 (quoting the United States' appellant's submission, para. 408).

(v) *Necessary findings of fact*

126. Brazil asserts that the United States' claim that the Panel did not make the necessary findings of fact should have been brought under Article 11 of the DSU and that, having failed to bring such a claim, the United States is precluded from challenging the Panel's appreciation of the facts.

127. In any event, Brazil submits that neither item (j), nor Articles 3.1(a) and 3.2 of the *SCM Agreement*, nor Articles 10.1 and 8 of the *Agreement on Agriculture*, required the Panel to make specific factual findings on the "monetary extent to which" premium rates are inadequate to cover the long-term operating costs and losses of the United States' export credit guarantee programs.<sup>121</sup> It was sufficient for the Panel to have found that, under any and all methodologies that it reviewed and accepted, premium rates are *inadequate* to cover the long-term operating costs and losses of the export credit guarantee programs.

128. In addition, Brazil asserts that the Panel made sufficient factual findings for its conclusion that premium rates are inadequate to cover the long-term operating costs and losses of the export credit guarantee programs. Specifically, the Panel assessed the performance of the export credit guarantee programs under the elements of item (j) in various ways. In its assessment of the *past* performance of the export credit guarantee programs during the period 1992-2002, the Panel used two accounting methodologies—net present value accounting and cash basis accounting—to determine whether premium rates are inadequate to cover the long-term operating costs and losses of the programs.

129. Brazil therefore requests that the Appellate Body uphold the Panel's finding that the United States' export credit guarantee programs constitute export subsidies within the meaning of item (j) of the Illustrative List of Export Subsidies and Articles 3.1 and 3.2 of the *SCM Agreement*.

C. *Claims of Error by Brazil – Appellant*

1. Domestic Support

(a) Article 13(a) of the *Agreement on Agriculture* – Base Period Update

130. Brazil conditionally appeals the Panel's exercise of judicial economy with respect to Brazil's claim that the "updating" of base acreage for direct payments under the FSRI Act of 2002 renders that program inconsistent with paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*. Brazil's appeal is conditional on the Appellate Body reversing the Panel's finding that production flexibility

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<sup>121</sup> Brazil's appellee's submission, para. 1046 (quoting the United States' appellant's submission, para. 419).

contract payments and direct payments are not decoupled income support under paragraph 6(b) of Annex 2 and thus not entitled to peace clause protection by virtue of Article 13(a) of the *Agreement on Agriculture*.

131. Brazil argues that the Panel made factual findings to the effect that the FSRI Act of 2002 created a new "base period" of time (marketing years 1998-2001) according to which upland cotton producers' eligibility for direct payments could be calculated. This new base period could replace the base period that had prevailed under the FAIR Act of 1996 (i.e., 1993-1995) for the calculation of production flexibility contract payments. In practical terms, the FSRI Act of 2002 gave producers who planted more upland cotton during 1998-2001 the chance to "update", that is, increase, the quantity of base acres for which they received direct payments.

132. Brazil recalls that paragraph 6(a) of Annex 2 states that "[e]ligibility for such payments shall be determined by clearly-defined criteria such as income, status as a producer or landowner, *factor use* or *production level in a defined and fixed base period*".<sup>122</sup> "Factor use" encompasses quantities of eligible farmland used in a historical period, such as the "base acres" used in the production flexibility contract and direct payment programs. Similarly, "production level" encompasses quantities of production based on historical acreage and yields, such as those used under the production flexibility contract and direct payment programs to calculate payments. If either the historical acreage or yields are updated, the result is a change in one of the "clearly-defined criteria". Yet paragraph 6(a) requires that both the "factor use" and "production level" criteria be set out in "a" single "fixed" base period.

133. Brazil notes that the ordinary meaning of the term "fixed" in relation to a base period is that the defined base period cannot be changed or updated. Accordingly, there can be only one period of time to establish these values; there can be no "updating" of the base period. Brazil contends that the context supports its interpretation. Moreover, the object and purpose of paragraph 6 of Annex 2 is to ensure that decoupled payments "have no, or at most minimal, trade-distorting effects or effects on production".<sup>123</sup> Paragraphs 5 and 6 of Annex 2 make clear that the purpose of "decoupled income support" is to break the link between production decisions and the amount of support. If that link is maintained, then domestic support is not entitled to the exemption from reduction commitments. Brazil submits that the United States' interpretation would effectively allow a Member to re-link last year's production to this year's payment. This would void paragraph 6(a) of any *effet utile*.

<sup>122</sup>Brazil's other appellant's submission, para. 246. (emphasis added by Brazil)

<sup>123</sup>*Ibid.*, para. 251 (quoting para. 1 of Annex 2 of the *Agreement on Agriculture*).

134. Brazil submits that the undisputed facts on the record reveal that production flexibility contract payments and direct payments were made to the same persons, on the same land, based on the same yield and payment formula, under the same conditions, and with the same limitations. Given these similarities, the option for a producer to select a new "fixed base period" other than the original "fixed base period" means that the direct payments are not green box measures under paragraph 6(a) of Annex 2. Brazil requests the Appellate Body to find accordingly.

## 2. Serious Prejudice

### (a) World Market Share under Article 6.3(d) of the *SCM Agreement*

135. Brazil appeals the Panel's finding that Brazil failed to establish a *prima facie* case of inconsistency with Articles 5(c) and 6.3(d) of the *SCM Agreement*. Brazil asks the Appellate Body to reverse the Panel's finding that the words "world market share" in Article 6.3(d) mean "the portion of the world's supply that is satisfied by the subsidizing Member's producers"<sup>124</sup> and to find instead that "world market share" means "world market share of exports".<sup>125</sup> In addition, if the Appellate Body reverses the Panel's finding that the effect of the price-contingent subsidies is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*, Brazil calls on the Appellate Body to complete the analysis under Article 6.3(d) and to find that the effect of these subsidies is an increase in the United States' world market share of exports within the meaning of Article 6.3(d), thereby constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*.

136. As regards the interpretation of the term "world market share" in Article 6.3(d) of the *SCM Agreement*, Brazil first draws support from the text of that provision. Article 6.3(d) does not specify whether "world market share" refers to world market share of production or world market share of something else. However, the use of the word "trade" in footnote 17 to Article 6.3(d) suggests that Article 6.3(d) is directed towards a Member's share of world trade in a product, which requires a focus on *exports* rather than *production*.

137. Secondly, Brazil refers to the context of Article 6.3(d). Brazil argues that Article XVI:3 of the GATT 1994 addresses a Member's "share of world export trade" and that similarities between Article XVI:3 and Article 6.3(d) require the phrase "world market share" in the latter provision to be read in the same way. Brazil also points to the context provided by paragraphs (a) and (b) of Article 6.3, as well as Articles 6.4 and 6.7, and argues that the focus of a serious prejudice analysis

<sup>124</sup>Brazil's other appellant's submission, para. 269 (quoting Panel Report, para. 7.143-4).

<sup>125</sup>*Ibid.*, para. 380(9). (original emphasis)

under Article 6.3 is on the effects of the subsidies on like products from the complaining Member. According to Brazil, "[t]hese effects are either manifest in aggregated volume effects on the exports of a complaining Member under Articles 6.3(a), 6.3(b) and 6.3(d), or in price effects on the like product of the complaining Member in the 'same market' under Article 6.3(c)".<sup>126</sup>

138. Thirdly, Brazil relies on the object and purpose of Articles 5(c) and 6.3 of the *SCM Agreement*, which it characterizes as being to discipline subsidies causing serious prejudice to the interests of another Member. As stated in Article XVI:1 of the GATT 1994 (to which footnote 13 to Article 5(c) of the *SCM Agreement* refers), serious prejudice is reflected in trade effects, namely decreased imports or increased exports. Increased production is taken into account in a serious prejudice analysis, because it may have trade effects. However, by focusing solely on the United States' share of world upland cotton production, the Panel disregarded the significant increase in the United States' share of world upland cotton exports from 1999 to 2002, which caused serious prejudice to other Members' producers who were competing against the subsidized exports. The Panel's interpretation means that the subsidizing Member's world market share may be significantly affected by unrelated increases in production in third countries, even if this additional production is consumed domestically. Brazil suggests that this would render Article 6.3(d) "largely inutile"<sup>127</sup> in disciplining the use of subsidies to increase market share.

139. For these reasons, Brazil asks the Appellate Body to reverse the Panel's interpretation of "world market share" under Article 6.3(d) of the *SCM Agreement* and to find instead that "world market share" means world market share of *exports*. Should it do so, and if the Appellate Body reverses the Panel's finding of significant price suppression under Article 6.3(c) of the *SCM Agreement*, Brazil asks the Appellate Body to complete the analysis under Article 6.3(d).

140. According to Brazil, factual findings by the Panel and undisputed facts on the record would allow the Appellate Body to complete the analysis under Article 6.3(d). The Panel's findings show that the United States' world market share of exports in marketing year 2002 was 39.9 percent, representing an increase over the previous three-year average of 28.4 percent.<sup>128</sup> Moreover, the Panel's assessment of the effects of the subsidies in its analysis under Article 6.3(c) confirms that the subsidies in question result in an increase in world market share, stimulate exports, and enhance the competitiveness of United States producers in world trade. Brazil submits that the Panel's causation and non-attribution analyses under Article 6.3(c) are also relevant for the causation analysis under

<sup>126</sup> Brazil's other appellant's submission, para. 287.

<sup>127</sup> *Ibid.*, para. 295.

<sup>128</sup> *Ibid.*, para. 301.

Article 6.3(d). It is appropriate for the Appellate Body to complete the analysis in this way because the Panel did address all the elements of Brazil's claim under Article 6.3(d) and, even if it had not, Articles 6.3(c) and 6.3(d) claims are "closely related" and "part of a logical continuum".<sup>129</sup> According to Brazil, both claims relate to the adverse effects of and serious prejudice caused by actionable subsidies pursuant to Article 5(c) of the *SCM Agreement*, and Articles 6.3(c) and 6.3(d) are "closely-linked steps in determining the consistency of"<sup>130</sup> actionable subsidies under the *SCM Agreement*.

### 3. Import Substitution Subsidies and Export Subsidies

(a) Share of World Export Trade under Article XVI:3 of the GATT 1994

141. Brazil appeals the Panel's finding that the second sentence of Article XVI:3 of the GATT 1994 applies only to export subsidies as defined in the *Agreement on Agriculture* and the *SCM Agreement*. Brazil asks the Appellate Body to reverse the Panel's finding that this sentence applies only to export subsidies and to find instead that it applies to "*any form of subsidy* which operates to increase the export of any primary product".<sup>131</sup> In addition, if the Appellate Body reverses the Panel's finding that the effect of the price-contingent subsidies is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*, and if the Appellate Body does not find that the effect of these subsidies is an increase in the United States' world market share of exports within the meaning of Article 6.3(d) constituting serious prejudice within the meaning of Article 5(c) of the *SCM Agreement*, Brazil calls on the Appellate Body to complete the analysis and to find that these subsidies are applied in a manner that results in the United States having "more than an equitable share of world export trade in" upland cotton, contrary to the second sentence of Article XVI:3 of the GATT 1994.

142. In relation to the subsidies subject to the second sentence of Article XVI:3 of the GATT 1994, Brazil first refers to the text of this sentence and, in particular, the words "any form of subsidy". The ordinary meaning of these words suggests that Article XVI:3 applies to every subsidy, no matter what kind or how many. In addition, the second sentence specifies that it does not matter whether the subsidy is granted "directly or indirectly". Brazil points out that, in contrast to the first sentence of Article XVI:3, which is concerned with subsidies *on the export* of primary products, the second sentence is concerned with any subsidies that have export-enhancing effects.

<sup>129</sup> Brazil's other appellant's submission, paras. 313 and 314 (quoting Appellate Body Report, *Canada – Periodicals*, p. 24, DSR 1997:1, 449 at 469; Appellate Body Report, *EC – Asbestos*, para. 79).

<sup>130</sup> *Ibid.*, para. 314 (quoting Appellate Body Report, *Canada – Periodicals*, p. 24, DSR 1997:1, 449 at 469).

<sup>131</sup> *Ibid.*, para. 317 (quoting the GATT 1994, Article XVI:3) (emphasis added by Brazil).

143. Secondly, turning to the broader context of Article XVI:3, Brazil contends that Part A of Article XVI disciplines subsidies in general, and Part B of Article XVI disciplines "Export Subsidies" (as specified in the heading to Part B) in particular. The wording of the provisions in Part B shows that "export subsidies" in this context means "subsidies on the export" of a primary product (under the first sentence of Article XVI:3) and subsidies that operate "to increase the export of any primary product" (under the second sentence of Article XVI:3). Brazil argues that, in contrast, the export subsidy disciplines in the *SCM Agreement* and the *Agreement on Agriculture* are concerned with the narrower concept of "subsidies contingent upon export performance".<sup>132</sup>

144. Brazil also refers, for contextual support, to Article 13 of the *Agreement on Agriculture*. Article 13(c)(ii) provides a limited exemption for agricultural export subsidies from Article XVI of the GATT 1994, suggesting that Article XVI:3 could otherwise apply to such subsidies. Similarly, Brazil contends that the conditional exemption in Article 13(a)(ii) suggests that, in principle, green box domestic support is subject to challenge under the second sentence of Article XVI:3.

145. Thirdly, with respect to the object and purpose of Article XVI of the GATT 1994 and Articles 5 and 6 of the *SCM Agreement*, Brazil suggests that these provisions are intended to prevent subsidies granted by Members from having certain adverse outcomes or effects. The purpose of disciplining adverse effects of subsidies in the second sentence of Article XVI:3 of the GATT 1994 would be frustrated if this sentence was interpreted to apply only to subsidies contingent on export performance. This interpretation would deprive the second sentence of Article XVI:3 of *effet utile*, because the disciplines in that sentence would no longer apply to many subsidies having export-enhancing effects.

146. Brazil adds that Article XVI:3 of the GATT 1994 continues to apply despite the disciplines in the *SCM Agreement* and the *Agreement on Agriculture*.<sup>133</sup> In interpreting the covered agreements harmoniously and giving effect to all of them, the second sentence of Article XVI:3 must apply to measures that are also subject to the *SCM Agreement* and the *Agreement on Agriculture*. The rules in Article 21.1 of the *Agreement on Agriculture* and the General Interpretative Note to Annex 1A of the *WTO Agreement* do not apply, because no conflict exists between the second sentence of Article XVI:3 of the GATT 1994 and the disciplines in the *Agreement on Agriculture* and the *SCM Agreement*.

<sup>132</sup>Brazil's other appellant's submission, para. 333 (quoting Article 1(e) of the *Agreement on Agriculture* and referring to Article 3.1(a) of the *SCM Agreement*).

<sup>133</sup>*Ibid.*, para. 345 (referring to Appellate Body Report, *Korea – Dairy*, para. 75; and Appellate Body Report, *Argentina – Footwear (EC)*, para. 81).

147. For these reasons, Brazil asks the Appellate Body to reverse the Panel's finding that the second sentence of Article XVI:3 of the GATT 1994 applies only to export subsidies as defined in the *Agreement on Agriculture* and the *SCM Agreement* and to find instead that this sentence applies to any form of subsidy that operates to increase the export of any primary product. Should it do so, and if the Appellate Body reverses the Panel's finding of significant price suppression under Article 6.3(c) of the *SCM Agreement* and does not find serious prejudice pursuant to Articles 5(c) and 6.3(d) of the *SCM Agreement*, Brazil asks the Appellate Body to complete the analysis under Article XVI:3 of the GATT 1994.

148. Brazil contends that the Panel's factual findings and the undisputed facts on the panel record are sufficient for the Appellate Body to find that the price-contingent subsidies caused the United States to have "more than an equitable share of world export trade", contrary to Article XVI:3 of the GATT 1994. The Panel made factual findings, pursuant to Article 6.3(c) of the *SCM Agreement*, regarding the United States' share of world export trade and the effect of the subsidies on that share. Brazil also submits that the Panel's non-attribution analysis would allow the Appellate Body to conclude that it was the subsidies in question that led to the United States' world market share reaching a level that is more than equitable, at the expense of other, more efficient producers.

(b) Export Credit Guarantees

(i) *Threat of circumvention*

149. Brazil asserts that the Panel erred in the interpretation and application of Article 10.1 of the *Agreement on Agriculture* by finding that "threat" of circumvention of export subsidy commitments would arise only if beneficiaries had an "absolute" or "unconditional statutory legal entitlement" to receive the subsidies such that the United States would "necessarily" be required to grant subsidies after the commitment level had been reached.<sup>134</sup> Brazil also takes issue with the Panel's statement that a "threat" could not arise if circumvention was just a *possibility*.<sup>135</sup>

150. According to Brazil, by its very nature, an obligation that covers the "threat" of circumvention deals with a future event whose actual occurrence is merely a possibility that cannot be assured with certainty.<sup>136</sup> Brazil adds that, even though the ordinary meaning of the term "threat" can encompass events that are a possibility or that appear likely, it can also include events whose occurrence is indicated or portended by circumstances. Furthermore, the meaning of the term "threatens" is

<sup>134</sup>Brazil's other appellant's submission, paras. 85-89 (quoting Panel Report, paras. 7.883 and 7.892).

<sup>135</sup>*Ibid.*, paras. 89 and 114 (referring to Panel Report, para. 7.893).

<sup>136</sup>*Ibid.*, para. 94 (referring to Appellate Body Report, *US – Lamb*, para. 125).

clarified by its immediate context, particularly the word "[p]revention" in the title of Article 10. Brazil thus contends that, to give proper meaning to the aim of prevention, the threat obligation should be read so as to thwart, forestall, or stop circumvention from occurring by requiring a Member to take appropriate precautionary action. If, on the contrary, the degree of likelihood necessary to trigger the threat obligation were set too high, the threat obligation would fail to prevent circumvention, contrary to the express aim of the provision.

151. Brazil distinguishes the meaning of "threatens" in the context of Article 10.1 of the *Agreement on Agriculture* from the connotation of that term in other covered agreements. It explains that the *Agreement on Safeguards* and the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* (the "*Anti-Dumping Agreement*") require a higher degree of likelihood because, under both Agreements, the demonstration of "threat" triggers the right of a WTO Member to apply trade remedy measures involving suspension or modification of WTO commitments. In contrast, Article 10.1 of the *Agreement on Agriculture* aims at the effective enforcement of a Member's export subsidy obligations. Brazil submits that the Panel's reading of Article 10.1 runs counter to the Appellate Body's decision in *US – FSC*, where the Appellate Body held that Article 10.1 applies if a measure "allows for" circumvention<sup>137</sup>, whereas the Panel insisted that circumvention must be required by legal entitlement. Brazil submits that the assessment of whether a threat exists under Article 10.1 must be done on a case-by-case basis and suggests a list of factors that could be considered as part of the assessment.<sup>138</sup>

152. Brazil also contends that the Panel erred by confirming its examination of threat of circumvention to scheduled agricultural products other than rice and to unscheduled products "not supported"<sup>139</sup> under the United States' export credit guarantee programs.<sup>140</sup> Brazil explains that, in addition to alleging actual circumvention in respect of rice, it also included this product in its claim of threat of circumvention. Brazil observes, furthermore, that it drew no distinctions between supported and unsupported products. Thus, the Panel's analysis of threat of circumvention should have included rice and all unscheduled products eligible to receive support under the export credit guarantee programs, regardless of whether they were in fact supported by such programs in the past.

<sup>137</sup>Brazil's other appellant's submission, paras. 126-129 (quoting Appellate Body Report, *US – FSC*, para. 152).

<sup>138</sup>*Ibid.*, para. 105.

<sup>139</sup>When the Panel refers to products supported under the export credit guarantee programs, the Panel is referring to products for which there was evidence in the record showing that they were not only eligible under the programs, but that export credit guarantees were in fact received in connection with exports of those products. (Panel Report, para. 6.32)

<sup>140</sup>Brazil's other appellant's submission, para. 132 (quoting Panel Report, para. 7.882).

153. Brazil argues that the Panel should have made a finding of threat of circumvention notwithstanding its conclusion on actual circumvention in respect of rice and unscheduled products supported under the United States' export credit guarantee programs. The prohibitions on actual and threatened circumvention are two separate obligations under Article 10.1 of the *Agreement on Agriculture*. The concepts of actual and threatened circumvention in Article 10.1 are different from the notions of injury and threat of injury in the trade remedies context. Article 10.1 does not confer rights, but imposes obligations. Accordingly, to hold that a Member has actually circumvented its export subsidy commitments in the past does not make it irrelevant to conclude that the Member continues to threaten circumvention in the future.

154. If the Appellate Body agrees with Brazil and modifies the Panel's interpretation of Article 10.1, Brazil requests that the Appellate Body complete the analysis of its claims. Brazil argues that the United States maintains export credit guarantees for a very wide range of scheduled and unscheduled agricultural products. These measures are subject to special budgetary rules that provide permanent and unlimited budget authority to the CCC to grant export credit guarantees. Therefore, Brazil asserts, no budgetary limits are imposed on the value of the subsidies that can be granted.

155. Brazil states that, even though the United States alleged before the Panel that the export credit guarantee programs are not unlimited because they impose certain conditions on the grant of subsidies, these conditions have no rational relationship whatsoever to ensuring respect for the United States' export subsidy commitments. There is no evidence on the record, according to Brazil, to demonstrate that any of the applicable conditions has ever been applied with a view to ensuring respect for the United States' export subsidy commitments. Moreover, none of these conditions has prevented the United States from consistently granting export credit guarantees for both scheduled and unscheduled products in violation of these commitments. Brazil contends that the authority that the United States enjoys to grant export credit guarantees in violation of its export subsidy commitments, coupled with the consistent pattern of granting behaviour in violation of those commitments, establishes that the United States' export credit guarantees are applied in a manner that threatens to lead to circumvention of the United States' export subsidy commitments for all eligible products, under Article 10.1 of the *Agreement on Agriculture*.

(ii) *Actual circumvention*

156. Brazil claims that the Panel erred in the application of Article 10.1 of the *Agreement on Agriculture*, and did not discharge its duties under Article 11 of the DSU, by finding that the United States' export credit guarantees are applied in a manner that results in circumvention of the United States' export subsidy commitments for only one scheduled product, namely rice.

157. Brazil submits that, according to uncontested evidence on the record, supplied by the United States, actual circumvention also occurred for pig meat and poultry meat in 2001.<sup>141</sup> According to figures supplied by the United States, in fiscal year 2001, the volume of pig meat and poultry meat benefiting from export credit guarantees exceeded the United States' reduction commitment levels for these products. The Panel took explicit cognizance of this information, but nonetheless failed to apply a proper interpretation of Article 10.1 to the admitted facts. Likewise, the Panel failed to make an objective assessment of the matter, including of admitted and uncontested facts supplied by the United States, as required by Article 11 of the DSU.

158. Therefore, Brazil requests that the Appellate Body modify the Panel's finding that the United States' export credit guarantees are applied in a manner that results in actual circumvention with respect to only one scheduled product, namely, rice, and that it find, based on the undisputed facts on the record, that export credit guarantees are applied in a manner that also results in actual circumvention with respect to pig meat and poultry meat.

(iii) *Articles 1.1 and 3.1(a) of the SCM Agreement*

159. Brazil appeals the Panel's finding that, having found that the United States' export credit guarantee programs are export subsidies under item (j) of the Illustrative List of Export Subsidies annexed to the *SCM Agreement*, it was unnecessary to address Brazil's claim that these programs constitute export subsidies under the terms of Articles 1.1 and 3.1(a) of the *SCM Agreement*. In declining to make a finding under these two Articles, the Panel erred in the interpretation and application of Article 3.1(a) of the *SCM Agreement*, as well as of Article 3.7 of the DSU.

160. According to Brazil, the Panel failed to recognize that Article 3.1(a) includes multiple and distinct obligations that differ from those deriving from item (j) of the Illustrative List of Export Subsidies. Most importantly, while a measure may no longer constitute an export subsidy under

<sup>141</sup>In its other appellant's submission, Brazil also claimed that the Panel erred by failing to find actual circumvention of the United States' export subsidy reduction commitments for vegetable oil in 2002. (Brazil's other appellant's submission, paras. 208-209) At the oral hearing, however, Brazil indicated that it was no longer pursuing this claim in respect of vegetable oil.

item (j), the same measure can still constitute an export subsidy under Articles 1.1 and 3.1(a) of the *SCM Agreement*. In the present dispute, a claim under item (j) of the Illustrative List of Export Subsidies requires a determination whether the programs involved a "net cost" to the United States government. In contrast, a claim under Articles 3.1(a) and 1.1 necessitates a determination of whether the programs constitute "financial contributions" that confer a "benefit" (within the meaning of Article 1.1 of the *SCM Agreement*) on recipients of export credit guarantees<sup>142</sup> and are "contingent ... upon export performance" (within the meaning of Article 3.1(a) of the *SCM Agreement*). These are two separate claims regarding two separate obligations imposed upon the United States. The first obligation of the United States is to refrain from maintaining export credit guarantee programs that entail financial contributions, confer benefits, and are contingent upon export performance, while its second obligation is to refrain from maintaining export credit guarantee programs that incur a net cost to the United States government.

161. Brazil submits that, by failing to examine these distinct claims, the Panel misapplied the principle of judicial economy<sup>143</sup> and failed to provide for a "prompt settlement" and "positive solution" of the dispute as required by Articles 3.3 and 3.7 of the DSU. The Panel's misapplication of the principle of judicial economy means that the recommendations and rulings of the DSB may not be sufficiently precise to resolve the dispute. The Panel left unresolved the dispute between the parties as to whether the export credit guarantee programs involve a "benefit", and the steps that the United States must take to implement its obligations under the *SCM Agreement* will therefore be unclear.

162. If the Appellate Body were to reverse the Panel's finding, Brazil requests that the Appellate Body complete the analysis and find that the United States' export credit guarantee programs constitute export subsidies under Articles 1.1 and 3.1(a) of the *SCM Agreement*. Brazil submits that it is undisputed that export credit guarantees constitute "financial contributions" and that the programs are "contingent ... upon export performance". Regarding the third element, i.e. whether the export credit guarantee programs confer a benefit within the meaning of Article 1.1(b) of the *SCM Agreement*, Brazil notes that the Appellate Body has sufficient factual findings and undisputed facts on the record to complete the analysis. Brazil explains that the record demonstrates that the United States' export credit guarantee programs confer a benefit because they: (i) are not risk-based; (ii) are below relevant benchmarks, including the fees charged by the United States Export-Import Bank for its own guarantees; and (iii) enable non-creditworthy purchasers of United States agricultural exports to secure loans they would otherwise be unable to secure.

<sup>142</sup>Brazil's other appellant's submission, paras. 29-30 (referring to Appellate Body Report, *Canada – Airframe*, paras. 154, 157).

<sup>143</sup>*Ibid.*, paras. 33-34 (referring to Appellate Body Report, *Australia – Salmon*, paras. 222-224).

(iv) *ETI Act of 2000*

163. Brazil appeals the finding of the Panel that Brazil did not establish a *prima facie* case of inconsistency of the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 (the "ETI Act of 2000"), and export subsidies granted thereunder in respect of upland cotton, with Articles 8 and 10.1 of the *Agreement on Agriculture*. Brazil acknowledges that the United States enacted legislation, on 25 October 2004, that "seems to repeal most of the illegal aspects of the ETI Act of 2000"<sup>144</sup> and, consequently, Brazil does not ask the Appellate Body to complete the analysis and to find that ETI Act export subsidies provided with respect to upland cotton exports are inconsistent with Articles 8 and 10.1 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement*.

164. Brazil contends that it challenged before the Panel exactly the same measure that the panel and the Appellate Body in *US – FSC (Article 21.5 – EC)* held to be inconsistent with the *Agreement on Agriculture* and the *SCM Agreement*. Except for the fact that Brazil challenges only the ETI Act export subsidies to upland cotton (and not with respect to all products), the "measure" and the "claims" in the present case are identical to those in *US – FSC (Article 21.5 – EC)*. According to Brazil, the United States has never challenged this identity.

165. Brazil alleges that the United States "effectively admitted" the inconsistency of the ETI Act of 2000 with Articles 10.1 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement* and never contested Brazil's claims on their merits.<sup>145</sup> Brazil explains that it presented to the Panel all the evidence and argumentation that had been before the panel and the Appellate Body in the earlier dispute relating to the ETI Act of 2000. Brazil incorporated by reference into its submissions (i) the panel report in *US – FSC (Article 21.5 – EC)*, (ii) the Appellate Body Report in *US – FSC (Article 21.5 – EC)*, and (iii) all submissions of the European Communities in that case. Brazil contends that an approach whereby the complaining Member incorporates by reference the reasoning of another panel, as modified by the Appellate Body, is consistent with the Appellate Body's reasoning in *Mexico – Corn Syrup (Article 21.5 – US)*.<sup>146</sup>

<sup>144</sup> Brazil's other appellant's submission, para. 214.

<sup>145</sup> *Ibid.*, para. 222.

<sup>146</sup> *Ibid.*, para. 224 (referring to Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 109).

166. Brazil asserts that, in addition to referencing the European Communities' claims and arguments in *US – FSC (Article 21.5 – EC)*, it presented arguments and evidence that addressed the specific nature of its claims, in particular with respect to Article 13(c)(ii) of the *Agreement on Agriculture*. Brazil submits that it identified the relevant portions of the *US – FSC (Article 21.5 – EC)* panel report that determined that the ETI Act of 2000 provides export subsidies. Specifically, that panel found that the ETI Act of 2000 (i) provides financial contributions within the meaning of Article 1.1(a)(ii) of the *SCM Agreement*, (ii) confers benefits within the meaning of Article 1.1(b), and thus (iii) bestows subsidies within the meaning of the *SCM Agreement* that (iv) are contingent upon export performance within the meaning of Article 3.1(a) of the *SCM Agreement*. Based on these arguments and findings, the Panel had more than sufficient evidence and arguments before it to conduct an objective examination of the consistency of the measure with the *Agreement on Agriculture* and the *SCM Agreement*. According to Brazil, the distinctions drawn by the Panel between the present dispute and the claims in *US – FSC (Article 21.5 – EC)* have no basis.

167. Brazil adds that, under Article 17.14 of the DSU, the parties to a dispute are unconditionally bound by adopted panel and Appellate Body reports.<sup>147</sup> Therefore, the United States is bound by the decision of the DSB to adopt the panel and Appellate Body Reports in *US – FSC (Article 21.5 – EC)* and the recommendation by the DSB that the United States bring the ETI Act of 2000 into conformity with the *Agreement on Agriculture* and the *SCM Agreement*. Despite the legal impossibility of the United States arguing that an identical measure subject to identical claims is WTO-consistent, the Panel nevertheless refused to take this into account in its assessment of the facts of the case and the matter before it.

168. Brazil states, moreover, that the ETI Act of 2000 is a measure that *all* WTO Members, *including the respondent*, have decided, through the adoption by the DSB of the relevant panel and Appellate Body reports, is inconsistent with the obligations of the United States under a covered agreement. The general rules on the burden of proof under the DSU, in essence, *presume* that a Member is in compliance with its obligations under WTO law and require a complaining Member to make a *prima facie* case that this presumption is misplaced. However, where the Members have decided in the DSB that a measure does not conform to a covered agreement, there is no basis for presuming that the same measure is in compliance with WTO law in another dispute. Any such presumption contradicts a formal DSB decision of the Members of the WTO.

<sup>147</sup> Brazil's other appellant's submission, para. 234 (referring to Appellate Body Report, *US – Shrimp (Article 21.5 – Malaysia)*, para. 97 and Appellate Body Report, *EC – Bed Linen (Article 21.5 – India)*, paras. 90-96).

169. Accordingly, Brazil requests the Appellate Body to find that the Panel erred in the interpretation and application of the burden of proof when finding that Brazil had not established *prima facie* that the ETI Act of 2000 violates Articles 8 and 10.1 of the *Agreement on Agriculture* and Article 3.1(a) and 3.2 of the *SCM Agreement*.

D. *Arguments of the United States – Appellee*

1. Domestic Support

(a) Article 13(a) of the *Agreement on Agriculture – Base Period Update*

170. The United States submits that the Appellate Body should reject Brazil's conditional appeal that direct payments under the FSRI Act of 2002 are not in conformity with the green box criteria set forth in paragraph 6(a) of Annex 2 to the *Agreement on Agriculture*, because the program uses a "defined and fixed base period" different from that established for the production flexibility contract program under the FAIR Act of 1996. The United States argues that the direct payment program employs "a defined and fixed base period" within the meaning of paragraph 6(a) and Brazil's appeal relies on an erroneous reading of that paragraph, such that once one type of green box payment to producers is made, *all* subsequent measures providing such support must be made with respect to the same base period.

171. The United States argues that the ordinary meaning of the terms "defined and fixed base period", as used in paragraph 6(a), requires a base period to be "set out precisely" and to be kept "stationary or unchanging in relative position."<sup>148</sup> Direct payments under the FSRI Act of 2002 satisfy this requirement because eligibility is determined by historical production of any of a number of crops (including upland cotton) in a base period that is "definite" (set out in the FSRI Act of 2002) and "stationary or unchanging in a relative position" (that is, does not change for the duration of the FSRI Act of 2002). There is no textual requirement in paragraph 6(a) that new decoupled income support measures must utilize the *same* "defined and fixed base period" as any prior measures. Furthermore, the use of "a" defined and fixed base period contrasts with the use of the phrase "*the* base period" in other provisions of Annexes 2 and 3 of the *Agreement on Agriculture*. The United States emphasizes that the direct payment and production flexibility contract programs are different measures. There is thus no legal requirement that they use the same base period, so long as they each make use of a "defined and fixed" base period.

<sup>148</sup>United States' appellee's submission, para. 128 (quoting *The New Shorter Oxford English Dictionary*, L. Brown (ed.) (Clarendon Press, 1993), Vol. 1, pp. 618 and 962).

172. The United States argues that Brazil's interpretation would foreclose reform options to Members with past green-box support programs, contrary to the object and purpose of the *WTO Agreement*. In addition, Brazil's interpretation of paragraph 6(a) would render direct payments under the FSRI Act of 2002 non-green box, even though the Panel implicitly found that such payments had no more than minimal trade-distorting effects or effects on production.

2. Serious Prejudice

(a) World Market Share under Article 6.3(d) of the *SCM Agreement*

173. The United States maintains that the Panel correctly found that Brazil did not establish a *prima facie* case of inconsistency with Articles 5(c) and 6.3(d) of the *SCM Agreement*. The United States requests the Appellate Body to uphold this finding. In particular, the United States requests the Appellate Body to dismiss Brazil's argument that the words "world market share" in Article 6.3(d) refer to "world market share of exports."<sup>149</sup> Even if the Appellate Body accepts this argument by Brazil, the United States requests the Appellate Body to dismiss the conditional request of Brazil that the Appellate Body complete the analysis and find that the effect of the price-contingent subsidies is an increase in the United States' world market share within the meaning of Article 6.3(d), thereby constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*.

174. According to the United States, Brazil's reading of "world market share" as meaning "world market share of export trade" is erroneous. First, the United States endorses the Panel's finding that, by using the term "market", Members intended a meaning broader than the share of "exports" or "trade". The United States contests Brazil's view that the Panel's interpretation of Article 6.3(d) reduces the provision to inutility. The United States agrees with the Panel that Article 6.3(d) calls for an examination of the portion of the world *market* that is satisfied by the subsidizing Member's producers. Nevertheless, the United States stresses that the Panel erroneously equated this examination with an examination of only that portion of the world's *supply* that is satisfied by the subsidizing Member's producers. The United States contends that the Panel should have looked at the level of world *sales* or *consumption* of cotton, rather than simply the world supply.

175. Secondly, as to the context of Article 6.3(d), the United States submits that the Panel was correct to conclude that the use of the phrase "world market share" (as opposed to the different formulations found in Article XVI:3 of the GATT 1994 and Article 27.6 of the *SCM Agreement*)

<sup>149</sup>United States' appellee's submission, para. 145 (quoting Brazil's other appellant's submission, para. 271). (original emphasis)

implies that Members did not want to restrict "world market share" to a Member's share of "world export trade" or "world trade". Similarly, unlike paragraphs (a) and (b) of Article 6.3, paragraph (d) of Article 6.3 is not explicitly restricted to any particular exports or imports or geographical area. The United States contends that the use of the word "trade" in footnote 17 to Article 6.3(d), but not in the text of the Article itself, implies that "world market share" does not include merely shares in world "trade".

176. Even if Brazil's interpretation of the words "world market share" in Article 6.3(d) were correct, the United States submits that the Appellate Body would not have sufficient factual findings and uncontroverted facts before it to complete the analysis under Article 6.3(d). The United States emphasizes that the Panel made no analysis with respect to causation and market share under Article 6.3(d). In the United States' submission, the Panel's "flawed"<sup>150</sup> analysis regarding the effect of the subsidy under Article 6.3(c) is not relevant to Brazil's request that the Appellate Body complete the analysis under Article 6.3(d) of the *SCM Agreement*.

### 3. Import Substitution Subsidies and Export Subsidies

(a) Share of World Export Trade under Article XVI:3 of the GATT 1994

177. The United States submits that the Panel properly found that Article XVI:3 of the GATT 1994 applies only to export subsidies as defined in the *Agreement on Agriculture* and the *SCM Agreement*. However, if the Appellate Body finds that Article XVI:3 applies to subsidies other than export subsidies, the United States asks the Appellate Body to find that Brazil has not established that the United States acted inconsistently with Article XVI:3 of the GATT 1994.

178. Beginning with the scope of Article XVI of the GATT 1994, the United States emphasizes that the text of Article XVI distinguishes between "Subsidies in General" (Part A) and "Additional Provisions on Export Subsidies" (Part B). By locating Article XVI:3 in Part B, Members agreed that Article XVI:3 is an additional provision on export subsidies. The term "export subsidy" is now defined in the *SCM Agreement* and the *Agreement on Agriculture* as referring to subsidies that are contingent on export performance. Both the context provided by these Agreements, as well as their drafting history, confirm that the export subsidies referred to in Article XVI:3 are also subsidies contingent on export performance. According to the United States, the Panel was correct to rely on Article 3.1(a) of the *SCM Agreement*, item (l) of the Illustrative List of Export Subsidies in Annex I

of the *SCM Agreement*, and the drafting history of the *Tokyo Round Subsidies Code* in concluding that Article XVI:3 of the GATT 1994 is concerned with certain export subsidies on primary products.

179. The United States contends that, even if the Appellate Body reverses the Panel's interpretation of the scope of Article XVI:3, there would be insufficient undisputed facts on the record or factual findings by the Panel for the Appellate Body to complete the analysis. The United States observes that the Panel made no findings on causation relative to trade share. As the "causation"<sup>151</sup> requirement under Article XVI:3 of the GATT 1994 differs from that under Article 6.3(c) of the *SCM Agreement*, and as the United States has appealed the Panel's analysis under Article 6.3(c), that analysis cannot support a finding of inconsistency under Article XVI:3. Regarding the standard for determining what is "more than an equitable share" of world export trade under Article XVI:3, the United States understands Brazil to argue that the demonstration of "any causal relationship between an increase in exports and the subsidies provided" would suffice.<sup>152</sup> However, the United States regards this standard as inadequate, because it renders the language "more than an equitable share" inutile, and it would transform Article XVI:3 into an outright prohibition on export-enhancing subsidies.

### (b) Export Credit Guarantees

#### (i) *Threat of circumvention*

180. The United States requests that the Appellate Body uphold the Panel's finding that no threat of circumvention exists under Article 10.1 of the *Agreement on Agriculture* with respect to "unsupported" agricultural products for which no export credit guarantees have been provided.

181. The United States asserts that, contrary to Brazil's argument, the Panel's finding that the export credit guarantee programs do not threaten circumvention of export subsidy commitments is not an articulation of a broad standard that circumvention of export subsidy commitments would be "threatened" only "if beneficiaries had an 'absolute' or 'unconditional ... legal entitlement' to receive the subsidies such that the United States would 'necessarily' be []required' to grant subsidies after the commitment level had been reached".<sup>153</sup> Rather, in concluding that the programs did not pose a threat of circumvention, the Panel was simply responding to and declining to adopt Brazil's erroneous factual and legal characterizations of the program.

<sup>151</sup>United States' appellee's submission, para. 182.

<sup>152</sup>*Ibid.*, para. 183 (quoting Brazil's other appellant's submission, para. 373).

<sup>153</sup>*Ibid.*, para. 6 (quoting Brazil's other appellant's submission, para. 3).

<sup>150</sup>United States' appellee's submission, para. 164.

182. The United States submits, furthermore, that the Panel rightly distinguished these programs from the mandatory subsidies at issue in *US – FSC*, and that the Panel's decision presents no conflict with that Appellate Body Report. Brazil effectively argued that a mere possibility of issuance of export credit guarantees presented a threat of circumvention, and the Panel simply did not adopt this theory in the context of the export credit guarantee programs.

183. In addition, the United States asserts that the Appellate Body need not complete the analysis regarding threat of circumvention as requested by Brazil. First, the Panel did not err in its analysis of threat of circumvention. Secondly, the Panel appropriately exercised judicial economy in declining to examine threat of circumvention with respect to those agricultural products for which it found actual circumvention. Further analysis was not necessary to resolve the matter in dispute as it would not affect implementation of the obligation to apply export subsidies only in conformity with applicable WTO commitments.

(ii) *Actual circumvention*

184. The United States asserts that the Appellate Body should reject Brazil's request for additional findings of actual circumvention of export subsidy commitments for pig meat and poultry meat.<sup>154</sup> According to the United States, Brazil has not asserted a proper claim under Article 11 of the DSU. The United States points out that Brazil does not appeal the Panel's findings that the facts did not demonstrate that subsidized exports exceeded the United States' quantitative reduction commitments for poultry meat and pig meat. Therefore, Brazil's appeal pursuant to Article 11 of the DSU is improper as it does not "stand by itself" and is not "substantiated with respect to the challenged findings".<sup>155</sup>

185. The United States submits that, in any event, the data do not support the conclusions that Brazil advances. Brazil's allegation of actual circumvention related to the period July 2001 through June 2002. In contrast, quantitative data on exports under the United States' export credit guarantee programs are maintained on a fiscal year basis, which extends from 1 October to 30 September. Even if this difference between periods can be overcome, the United States argues that the actual data also support the Panel's finding that Brazil did not demonstrate actual circumvention for these products.

<sup>154</sup>The United States also rejected the allegations in respect of vegetable oil made by Brazil in its other appellant's submission.

<sup>155</sup>United States' appellee's submission, para. 50 (referring to Appellate Body Report, *US – Steel Safeguards*, para. 498).

(iii) *Articles 1.1 and 3.1(a) of the SCM Agreement*

186. The United States asserts that the Appellate Body should reject Brazil's request for further findings under Article 3.1(a) of the *SCM Agreement* in addition to the finding the Panel made in respect of item (j) of the Illustrative List of Export Subsidies. The United States submits that, in the light of the Panel's finding that the United States' export credit guarantee programs constitute a prohibited export subsidy because the premium rates were inadequate to cover the long-term operating costs and losses of the program, any additional findings by the Panel would have been redundant. Neither item (j) nor the Illustrative List of Export Subsidies imposes obligations *per se*; instead, the obligation regarding export subsidies is found in Articles 3.1(a) and 3.2 of the *SCM Agreement*. Furthermore, Brazil's interpretation would render the Illustrative List of Export Subsidies meaningless. In the United States' view, a practice that does not constitute a prohibited export subsidy under the standard set forth in a particular item of the Illustrative List, such as item (j), cannot constitute a prohibited export subsidy under some other standard. This was the approach advocated by Brazil in the *Brazil – Aircraft* dispute. Moreover, the United States argues that an additional finding by the Panel would have had no effect on implementation. Whether or not a separate finding of "benefit" were made under Article 1.1, the Panel's recommendations would remain precisely the same.

187. The United States also observes that Brazil misconstrues what the Panel decided. The Panel did not decline to address a claim raised by Brazil. Instead, the Panel declined to make additional *factual findings* that Brazil requested. In any event, the United States contends that Brazil misinterprets the concept of judicial economy and that, even if Brazil made a separate claim, the Panel was within the bounds of its discretion in exercising judicial economy with respect to that claim.

188. Finally, the United States disagrees with Brazil's assertion that there are sufficient undisputed facts in the record that would enable the Appellate Body to complete the analysis. According to the United States, it vigorously contested Brazil's allegations of fact in this regard and affirmatively demonstrated that the export credit guarantee programs do not confer such a benefit. The United States explains that no benefit is conferred because identical financial instruments are available in the marketplace in the form of "forfeiting"<sup>156</sup>, there is no correlation between the issuance of the export credit guarantee and the ability of an importer to secure a loan; and the CCC conducts a risk assessment with respect to the foreign banks to whose risk it is exposed.

<sup>156</sup>United States' appellee's submission, para. 93.

(iv) *ETI Act of 2000*

189. The United States submits that the Appellate Body should reject Brazil's request that it find that the Panel erred in concluding that Brazil did not make a *prima facie* case that the ETI Act of 2000 is inconsistent with the United States' WTO obligations.

190. According to the United States, the Appellate Body should not rule on Brazil's appeal because Brazil acknowledges that the appeal is not necessary to resolve the dispute between the parties. Brazil states that it does not ask the Appellate Body to complete the analysis with respect to its claims. Brazil, therefore, is not asking the Appellate Body to make findings that would result in DSB rulings and recommendations with respect to the ETI Act of 2000.<sup>157</sup> For that reason alone, the Appellate Body should decline to decide Brazil's appeal.

191. The United States contends that, in any event, Brazil did not make a *prima facie* case with respect to the ETI Act of 2000. Brazil simply did not present any evidence at all regarding the ETI Act of 2000 itself. In its submission, Brazil gave a brief description of the proceedings in the *US – FSC (Article 21.5 – EC)* dispute and then asked the Panel "to apply the reasoning as developed by the panel and as modified by the Appellate Body in that case *mutatis mutandis*".<sup>158</sup> In essence, therefore, Brazil was not asking the Panel to make an objective assessment of the ETI Act of 2000, but merely to adopt findings from a previous proceeding. The Panel acted properly under the DSU, including Article 11, by declining to find that the "short shrift" that Brazil gave to the ETI Act of 2000 satisfied Brazil's burden to make its *prima facie* case concerning that Act.<sup>159</sup>

192. The United States asserts that the rules of burden of proof in the WTO are well settled. Contrary to Brazil's arguments, a finding of inconsistency in one dispute does not establish a finding of inconsistency in another dispute between different parties. Such an approach would in effect impose the concept of *stare decisis* on the WTO dispute settlement system. The United States also disagrees with Brazil's assumption that it is legally impossible for a party to argue that an identical measure subject to identical claims that were successful in a previous WTO dispute is WTO-consistent. The reasoning of a panel or the Appellate Body in one dispute is not binding on another panel or the Appellate Body in a separate dispute. Furthermore, while the measure may remain the

<sup>157</sup>United States' appellee's submission, paras. 101-104 (referring to Appellate Body Report, *US – Steel Safeguards*, para. 483 and Appellate Body Report, *US – Wool Shirts and Blouses*, p. 19, DSR 1997:1, 323 at 340).

<sup>158</sup>*Ibid.*, para. 106 (quoting Brazil's written submission to the Panel, paras. 315-327).

<sup>159</sup>*Ibid.*, para. 12.

same, the circumstances may change. Thus, irrespective of the ruling in the previous dispute, Brazil had the burden of establishing a *prima facie* case.

193. Finally, the United States argues that the Appellate Body's reasoning in *Mexico – Corn Syrup (Article 21.5 – US)* does not support Brazil's approach. Brazil exaggerates the Appellate Body's statements in that Report and does not explain why a complainant's obligation to make a *prima facie* case should be interpreted similarly to a panel's obligation to set forth its basic rationale pursuant to Article 12.7 of the DSU.

E. *Arguments of the Third Participants*1. Argentina(a) Article 13(a) of the *Agreement on Agriculture*

194. Argentina considers that green box measures must respect the "fundamental requirement" of paragraph 1 of Annex 2 of avoiding trade-distorting or production effects. Argentina submits that this requirement is additional to compliance with the policy-specific criteria of paragraph 6.

(i) *Article 13(a) of the Agreement on Agriculture – Planting Flexibility Limitations*

195. Argentina submits that production flexibility contract payments and direct payments do not comply with paragraph 6(b) of Annex 2 of the *Agreement on Agriculture* because the amount of these payments is related to the type of production after the base period. Argentina disagrees with the United States' view that paragraph 6(b) does not prevent the conditioning of payment upon fulfilling the requirement not to produce certain crops. Argentina considers that the Panel rightly affirmed that "the planting flexibility limitations provide a monetary incentive for payment recipients not to produce the prohibited crops".<sup>160</sup> For Argentina, there is effectively little difference between a "positive" and a "negative" list of permitted crops. The context provided by paragraphs 11(b) and 11(e) of Annex 2 supports this view. Although Argentina agrees with the United States that paragraph 6(b) ensures that the amount of payments must not be used to induce a recipient to produce a particular type of crop, the production flexibility contract and direct payments fail to meet this requirement. Argentina considers that the flexibility enjoyed by producers to plant different crops is illusory. The amount of the payments depends on the type of production. The growing of fruits and vegetables is prohibited under these programs, with the effect of channelling production towards other, permitted crops.

<sup>160</sup>Argentina's third participant's submission, para. 15 (quoting Panel Report, para. 7.386).

(ii) *Article 13(a) of the Agreement on Agriculture – Base Period Update*

196. Argentina agrees with Brazil that the option under the FSRI Act of 2002 to update base acres is inconsistent with paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*. Argentina submits

that the term "defined" in paragraph 6(a) refers to the need for the base period to be clearly determined. Likewise, the term "fixed" refers to the need for the base period to be defined in terms that prevent it from being shifted or modified *a posteriori*. The term "fixed" indicates that payments made in accordance with the criteria stipulated in paragraph 6(a) must always rely on the same base period, and no change is possible. Paragraph 6(a) thus allows Members to identify their own base period; however, once that period is determined, the period must remain fixed. Otherwise, the choice of the word "a" in paragraph 6(a) would be difficult to explain. Argentina thus agrees with Brazil that if the structure, design, and eligibility criteria of an original measure containing a "fixed base period" and the structure, design, and eligibility criteria of its successor have not been significantly modified, then it is not legitimate to update the "fixed base period" under the successor measure. Accordingly, the terms of the direct payment program under the FSRI Act of 2002 are inconsistent with the requirements set forth in paragraph 6(a) of Annex 2.

(b) *Significant Price Suppression under Article 6.3(c) of the SCM Agreement*

197. Argentina agrees with Brazil that the market examined in assessing significant price suppression under Article 6.3(c) of the *SCM Agreement* may be a world market, and that a panel need not quantify precisely the amount of a subsidy in conducting such an assessment.<sup>161</sup>

(c) *World Market Share under Article 6.3(d) of the SCM Agreement*

198. Argentina agrees with Brazil that the words "world market share" in Article 6.3(d) of the *SCM Agreement* refer to the subsidizing Member's share of the world export market.<sup>162</sup>

(d) *Step 2 Payments to Domestic Users*

199. Argentina agrees with the Panel's conclusion that Step 2 payments to domestic users of upland cotton constitute a subsidy contingent upon the use of domestic over imported goods that is prohibited by Articles 3.1(b) and 3.2 of the *SCM Agreement*, and that WTO Members are not authorized by the *Agreement on Agriculture* to provide such subsidies.

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<sup>161</sup> Argentina's statement at the oral hearing.

<sup>162</sup> *Ibid.*

(e) Export Credit Guarantees – Articles 10.1 and 10.2 of the *Agreement on Agriculture*

200. Argentina submits that the United States' export credit guarantee programs constitute export subsidies in breach of the anti-circumvention provision contained in Article 10.1 of the *Agreement on Agriculture* and, consequently, they are inconsistent with Article 8 and are not exempt from action under Article 13(c) of that Agreement. Argentina disagrees with the United States' view that no disciplines apply to export credit guarantee programs. On the contrary, under the terms of Article 10.1 of the *Agreement on Agriculture*, export credit guarantee programs constituting export subsidies should not be applied in a manner that results in, or threatens to lead to, circumvention of export subsidy commitments.

(f) Export Credit Guarantees – Articles 1 and 3.1(a) of the *SCM Agreement*

201. According to Argentina, the Panel's findings in respect of the United States' export credit guarantee programs are not complete. In not finding that such programs are also subsidies in accordance with the definition contained in Article 1 of the *SCM Agreement* and the prohibition in Article 3.1(a) of the same Agreement, the Panel did not bear in mind that different obligations stem from those Articles and that, similarly, the course of implementation adopted by a Member in respect of a finding of inconsistency only on the basis of item (j) of the Illustrative List of Export Subsidies may be different. Accordingly, Argentina contends that a finding of inconsistency in respect of the United States' export credit guarantee programs is also possible and should be made on the basis of Articles 1 and 3.1(a) of the *SCM Agreement*.

## 2. Australia

(a) Article 13(a) of the *Agreement on Agriculture* – Planting Flexibility Limitations

202. Australia requests that the Appellate Body uphold the Panel's conclusion that production flexibility contract payments, direct payments, and the legislative and regulatory provisions that establish and maintain the direct payment program, do not fully conform to paragraph 6(b) of Annex 2 of the *Agreement on Agriculture*. Australia submits that making a payment conditional upon the non-production of a particular product is one way in which a Member can relate the "amount of ... payment[]" to the current "type or volume of production". Australia contends that the argument advanced by the United States would introduce an exception into paragraph 6(b) of Annex 2 that has no textual basis. Australia submits that the Panel's interpretation does not prevent payments from being disallowed in the case of illegal production because reducing the payment to zero would be

based on the illegality of the activity, not "the type or volume of production". In addition, a Member could otherwise justify such a measure pursuant to Article XX of the GATT 1994.

(b) Article 13(a) of the *Agreement on Agriculture* – Base Period Update

203. Australia submits that the updating of base acres by the FSRI Act of 2002 means that the direct payments are not green box measures. Australia argues that the meaning of paragraph 6(b) of Annex 2 of the *Agreement on Agriculture* is that, once a base period has been "defined and fixed" pursuant to paragraph 6(a), decoupled income support payments may not be "connected" to or "[found]ed], built[] or construct[ed]" on the type of production or the volume of production undertaken by a producer in a later period.<sup>163</sup> Australia says that the Panel found that the direct payments program is the successor to the production flexibility contract program and that the two programs are identical in a number of important respects. The option under the FSRI Act of 2002 for producers to update their base acres is not consistent with the requirement of paragraph 6(a) that there be one "defined and fixed base period".

(c) Significant Price Suppression under Article 6.3(c) of the *SCM Agreement*

204. Australia refers to the United States' argument that the Panel failed to set out the findings of fact, the applicability of relevant provisions, and the basic rationale behind certain of its findings and recommendations regarding Article 6.3(c) of the *SCM Agreement*, as required by Article 12.7 of the DSU.<sup>164</sup> According to Australia, this argument suggests that the Panel failed to make an objective assessment of the matter before it, as required by Article 11 of the DSU. Australia notes that the Appellate Body has recognized the discretion of a panel in choosing the evidence on which it relies.<sup>165</sup>

(d) Step 2 Payments to Domestic Users and Exporters

205. Australia requests that the Appellate Body uphold the Panel's conclusions that Step 2 payments to domestic users constitute subsidies that are inconsistent with the requirements of Article 3.1(b) of the *SCM Agreement*.

<sup>163</sup> Australia's third participant's submission, para. 42 (quoting *The New Shorter Oxford English Dictionary*, L. Brown (ed.) (Clarendon Press, 1993), Vol. 1, p. 187 and Vol. 2, p. 2534 in relation to the words "based on" and, "related to" in paragraph 6(b) of Annex 2 to the *Agreement on Agriculture*).

<sup>164</sup> *Ibid.*, para. 19 (referring to the United States' appellant's submission, paras. 150 and 322-331).

<sup>165</sup> *Ibid.*, para. 21 (referring to Appellate Body Report, *EC – Hormones*, para. 135).

206. Australia submits that the Appellate Body should also uphold the Panel's conclusions that Step 2 payments to exporters are inconsistent with Articles 3.3 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement*. In the event that the Appellate Body determines that the Step 2 program is not export-contingent, Australia requests that the Appellate Body find that the Step 2 program *as a whole* is contingent upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the *SCM Agreement*. Furthermore, in that case, the Appellate Body should find that the chapeau to Article 3.1 of the *SCM Agreement* does not serve to exempt such local content subsidies from the application of Article 3.1(b) of that Agreement.

(e) Export Credit Guarantees – Articles 10.1 and 10.2 of the *Agreement on Agriculture*

207. Australia disagrees with the United States' argument that export credit guarantees are excluded from the application of Article 10.1 of the *Agreement on Agriculture* and Article 3.1(a) of the *SCM Agreement*. According to Australia, the United States has incorrectly applied Articles 31 and 32 of the *Vienna Convention* to the interpretation of Article 10.1 of the *Agreement on Agriculture*. Article 10.1 applies to all "[e]xport subsidies not listed in paragraph 1 of Article 9". The meaning of this provision is clearly discernible from its text and it does not provide for any exceptions. The context of Article 10.2 does not support an interpretation that would be contrary to its plain words, particularly because it is not constructed as an exception provision. The object and purpose of Article 10.1 relate to the prevention of circumvention of commitments, in relation to *all* export subsidies other than those listed in Article 9.1 of the *Agreement on Agriculture*. Furthermore, the application of Article 10.1 to export credit guarantees defined as export subsidies does not lead to a result that is manifestly unreasonable because not all export credit guarantees are export subsidies within the meaning of the *Agreement on Agriculture* and the *SCM Agreement*. It is open to the United States, within the existing WTO framework, to design and maintain measures that fall outside the definition of an export subsidy, which is, in fact, what the United States asserts it has done. In contrast, acceptance of the United States' arguments could lead to a result that is manifestly absurd or unreasonable by encouraging other WTO Members to seek to avoid the anti-circumvention obligations of Article 10.1 of the *Agreement on Agriculture*.

208. Australia also rejects the United States' contention that Article 21.1 of the *Agreement on Agriculture* and the chapeau to Article 3.1 of the *SCM Agreement* render Article 3.1(a) of the *SCM Agreement* inapplicable to export credit guarantee programs.

3. Benin and Chad

(a) Significant Price Suppression under Article 6.3(c) of the *SCM Agreement*

209. Benin and Chad agree with Brazil that the Panel correctly found that the effect of the price-contingent subsidies is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*. Benin and Chad contend that many of the United States' arguments regarding Article 6.3(c) relate to factual findings by the Panel that are not subject to appellate review in the absence of a claim by the United States that the Panel failed to comply with Article 11 of the DSU.

210. Benin and Chad agree with the Panel's finding that it was not required to quantify precisely the amount of the subsidy in assessing Brazil's claim under Article 6.3(c) of the *SCM Agreement*, and that the amount of a subsidy is not necessarily determinative in such an assessment. This is consistent with the different purposes of Parts III and V of the *SCM Agreement*.

(b) World Market Share under Article 6.3(d) of the *SCM Agreement*

211. Benin and Chad support the request by Brazil that the Appellate Body reverse the Panel's interpretation of the term "world market share" in Article 6.3(d) of the *SCM Agreement*. Benin and Chad agree with Brazil that "world market share" means world market share of *exports*. If the Appellate Body adopts this interpretation, Benin and Chad request the Appellate Body to complete the analysis under Article 6.3(d) and to find that the effect of the price-contingent subsidies was an increase in the world market share of the United States contrary to Article 6.3(d). In turn, Benin and Chad ask the Appellate Body to find that they have also suffered serious prejudice under Article 6.3(d) as a result of the increase in the United States' world market share of exports.

212. According to Benin and Chad, the Panel's interpretation of "world market share" as world market share of *production* inappropriately shifts the inquiry away from the *effect* of the subsidy towards unrelated factors, such as production levels in third country markets. A subsidy may have the effect of increasing significantly the exports of a Member, even though the Member's world share of production remains stable or diminishes. Therefore, in the submission of Benin and Chad, the Panel's interpretation could lead to a situation where changes in the supply by a third country determine whether a subsidizing Member's world market share increases or decreases.

213. Benin and Chad state that, if the Appellate Body rejects the Panel's interpretation of "world market share" under Article 6.3(d), there are sufficient undisputed facts on the record for the Appellate Body to complete the analysis and to find that the United States acted inconsistently with Article 6.3(d). The evidence before the Panel indicates that those Members that have lost market

share as a result of the price-contingent subsidies include, at least, Brazil and the "Francophone African nations of Benin and Chad".<sup>166</sup> Benin and Chad disagree with the Panel's finding that "the serious prejudice under examination by a WTO panel is the serious prejudice experienced by the complaining Member".<sup>167</sup>

214. Benin and Chad argue that the Appellate Body should take into account the impact of United States upland cotton subsidies on the "fragile economies of West and Central Africa"<sup>168</sup>, as reflected in the Panel's findings and evidence on the record. Benin and Chad point out that Article 24.1 of the DSU, which requires particular consideration to be given to the special situation of least-developed country Members, would be given meaning if the Appellate Body acknowledged that the increase in the United States' world market share caused serious prejudice to Benin and Chad by reducing their market share. Furthermore, nothing in the text of Article 6.3(d) limits a finding of serious prejudice to the complaining party. Therefore, Benin and Chad urge the Appellate Body to draw conclusions under Article 6.3(d) that would require the United States to withdraw the subsidy or remove the adverse effects, not only with respect to Brazil, but also with respect to Benin and Chad.

(c) Export Credit Guarantees – Articles 1 and 3.1(a) of the *SCM Agreement*

215. Benin and Chad support Brazil's position that the Panel improperly exercised judicial economy by refusing to address Brazil's claim that the United States violated Articles 1.1 and 3.1(a) of the *SCM Agreement* with respect to export credit guarantees. Benin and Chad also support Brazil's request that the Appellate Body complete the analysis as it has sufficient factual findings before it to do so.

216. Benin and Chad explain that, under item (j) of the Illustrative List of Export Subsidies, Brazil's claim is that the export credit guarantee programs operate at a loss or below the cost to the government. In contrast, under Article 3.1(a), Brazil's claim is that the programs are financial contributions that confer a benefit on recipients within the meaning of Article 1.1 of the *SCM Agreement* and that they are contingent upon export performance. Thus, Brazil's claims under item (j) of the Illustrative List of Export Subsidies and Article 3.1(a) were distinct, and the Panel's

<sup>166</sup> Benin and Chad's third participants' submission, para. 85. (emphasis omitted)

<sup>167</sup> *Ibid.*, para. 6 (quoting Panel Report, para. 7.1403).

<sup>168</sup> *Ibid.*, para. 9.

refusal to address Brazil's claim under Article 3.1(a) leaves an important and distinct claim unresolved. Accordingly, it was improper for the Panel to have exercised judicial economy.<sup>169</sup>

4. Canada

(a) Article 13(a) of the *Agreement on Agriculture – Planting Flexibility Limitations*

217. Canada considers that the Panel was correct in finding that production flexibility contract payments and direct payments do not meet the requirements of paragraph 6(b) of Annex 2 of the *Agreement on Agriculture*. For Canada, nothing in the text of paragraph 6(b) supports the distinction the United States seeks to draw between "positive" and "negative" effects on production. If payments are conditioned on a recipient not undertaking a type of production, then the payment is related to the type of production. Canada thus agrees with the Panel's interpretation that paragraph 6(b) excludes any "typ[e] of relationship between the amount of such payments and the type of production after the base period".<sup>170</sup> Canada argues that this approach is supported by the object and purpose of Annex 2 and the context provided by the fundamental requirement set out in paragraph 1 of Annex 2.

218. Canada agrees with the United States that the fundamental requirement in paragraph 1 of Annex 2 is relevant context in understanding the criterion in paragraph 6(b) that the measure not be related to the type or volume of production. However, a Member does not have an independent basis for claiming that the measure qualifies as a "green box" measure because it has minimal trade-distorting effects. Canada disagrees with the United States' conclusion, based on its interpretation of paragraph 6(e), that a Member is not prohibited under paragraph 6(b) from conditioning payment on non-production of a particular product. Canada considers that paragraph 6(e) is a prohibition against requiring production as a condition of payment, but does not necessarily authorize a Member to impose a requirement not to produce a particular crop. With regard to the planting flexibility limitations under the production flexibility contract payment and direct payment programs, Canada disagrees with the United States that the amount of payments "does not relate to fruit or vegetable production since for that base acre there would be *no payment at all*".<sup>171</sup> For Canada, this interpretation is contrary to the ordinary meaning of the term "related to" and leads to the unreasonable result that a Member could circumvent the requirement in paragraph 6(b) by

<sup>169</sup> Benin and Chad's third participants' submission, paras. 105-108 (referring to Appellate Body Report, *Australia – Salmon*, para. 223 and Appellate Body Report, *Canada – Wheat Exports and Grain Imports*, para. 133).

<sup>170</sup> Canada's third participant's submission, para. 13 (quoting Panel Report, para. 7.366).

<sup>171</sup> *Ibid.*, para. 20 (quoting the United States' appellants' submission, para. 26). (original emphasis)

encouraging certain types of production as long as it does so through a negative list by excluding certain other types of production.

(b) Article 13(a) of the *Agreement on Agriculture* – Base Period Update

219. Canada argues that the direct payments do not fully conform to paragraph 6(a) of Annex 2 of the *Agreement on Agriculture* because of the base period update in the FSRI Act of 2002. Canada submits that the ordinary meaning of the terms "defined and fixed base period" in paragraph 6(a) indicates that the base period cannot vary or change. This is confirmed by the context provided by paragraphs 6(b) and (d), which refer to "any year after the base period", as well as the object and purpose of paragraph 6, which is to identify the types of payments that are minimally trade-distorting. Canada contends that, as the Panel found that direct payments under the FSRI Act of 2002 are closely related to and a successor to the production flexibility contract payments, the base period for direct payments should not be different from the base period for production flexibility contract payments. The fact that payments are provided under new legislation does not in itself allow a modification to the base period under the predecessor program. Otherwise, the requirement that there be a "fixed base period" would become meaningless. By allowing updating of base acreage, the United States is altering the base period contrary to paragraph 6(a).

(c) Export Credit Guarantees – Articles 10.1 and 10.2 of the *Agreement on Agriculture*

220. Canada submits that the Panel correctly found that, to the extent that export credit guarantees meet the definition of export subsidies, they will be subject to the anti-circumvention disciplines of Article 10.1 of the *Agreement on Agriculture*. The United States' argument that Article 10.2 of the *Agreement on Agriculture* exempts export credit guarantees from the subsidy disciplines under that Agreement has no basis in the text, context, object and purpose, or negotiating history. Canada asserts that the text of Article 10.2 does not explicitly indicate an intention to exclude the application of other, existing disciplines. Indeed, such an interpretation would contradict the stated object and purpose of Article 10 as a whole, which is the "Prevention of Circumvention of Export Subsidy Commitments". Furthermore, the fact that export credit guarantee programs may not be subject to the notification requirement of the *Agreement on Agriculture* does not lead to the conclusion that they are not subject to the other disciplines of that Agreement.

221. Canada also agrees with the Panel's conclusion that the United States violated Articles 3.3 and 8 of the *Agreement on Agriculture* by providing export subsidies otherwise than in conformity with that Agreement with respect to upland cotton and other unscheduled commodities. In addition, Canada states that the Panel's interpretation of Article 10.1 with respect to scheduled products is consistent with the Appellate Body's analysis in *US – FSC*.<sup>172</sup>

(d) Export Credit Guarantees – Articles 1 and 3.1(a) of the *SCM Agreement*

222. Canada asserts that, if the Appellate Body reverses the Panel's finding that the United States' export credit guarantee programs constitute *per se* prohibited export subsidies under item (j) of the Illustrative List of Export Subsidies, it will still be necessary to consider whether the export credit guarantee programs constitute export subsidies under Articles 1 and 3.1(a) of the *SCM Agreement*. Even if the United States' export credit programs charge adequate fees under the item (j) standard, they may still confer an export subsidy. If they did, the export credit guarantees would have to be provided in a manner consistent with Article 10.1 of the *Agreement on Agriculture*.

5. China

(a) Terms of Reference – Expired Measures

223. China submits that the Panel was correct to find that expired production flexibility contract and market loss assistance payments were within the Panel's terms of reference. The Panel's interpretation of Articles 4.2 and 6.2 of the DSU is in accordance with the text, context, and object and purpose of the DSU, as well as the intention of the drafters. China recalls that Article 4.2 of the DSU indicates that consultations are to cover "any representations made by another Member concerning measures affecting the operation of any covered agreement taken within the territory of the former". China "agrees with the Panel that based on the analysis of the context and the object of Article 4.2, the term 'affecting' in Article 4.2 is used as a gerund, describing the way in which they relate to a covered agreement, and has no temporal significance".<sup>173</sup> China notes that Brazil's claims in this case relate to serious prejudice under the provisions of the *SCM Agreement* and the GATT 1994. China agrees with the panel in *Indonesia – Autos* that, "[i]f ...past subsidies were not relevant to [a] serious prejudice analysis as they were 'expired measures'..., it is hard to imagine any situation where a panel would be able to determine the existence of actual serious prejudice".<sup>174</sup>

<sup>172</sup>Canada's third participant's submission, para. 40 (referring to Appellate Body Report, *US – FSC*, para. 152).

<sup>173</sup>China's third participant's submission, para. 19.

<sup>174</sup>*Ibid.*, para. 26 (quoting Panel Report, *Indonesia – Autos*, para. 14.206).

China submits that neither the context cited by the United States nor the decisions of the panel and Appellate Body in *US – Certain EC Products* support the view that expired measures may not fall within the terms of reference of a panel.

- (b) Article 13(b) of the *Agreement on Agriculture* - Interpretation of "support to a specific commodity"

224. China supports the Panel's finding that the phrase "support to a specific commodity" in Article 13(b) of the *Agreement on Agriculture* does not mean "product-specific domestic support". China submits that the word "specific" in Article 13(b)(ii) is inserted to avoid lump-sum treatment of measures generally applicable to a number of commodities. Unlike the phrase "product-specific support", the phrase "support to a specific commodity" refers to the level of support delivered to a specific commodity, thus combining both product-specific support and the portion of support attributable to upland cotton under a program that is available to a number of products.

- (c) Terms of Reference – Export Credit Guarantees

225. China submits that the Appellate Body should uphold the Panel's conclusion that export credit guarantees to facilitate the export of United States agricultural commodities other than upland cotton were within the Panel's terms of reference. According to China, the Panel correctly concluded that Brazil identified export credit guarantees to agricultural commodities other than upland cotton in its request for consultations. During the consultations, Brazil also posed questions to the United States on the export credit guarantees that related to agricultural commodities other than upland cotton. These questions did not expand the scope of the consultations request, but merely clarified its content. In addition, China states that Brazil's recognition that the United States objected to the questions relating to agricultural commodities other than upland cotton does not lead to the conclusion that consultations were not held on the subject. Finally, China asserts that a WTO Member cannot refuse to respond to questions during consultations on the basis of its own uncertainty as to the scope of the consultations.

## 6. European Communities

- (a) Article 13(a) of the *Agreement on Agriculture* – Planting Flexibility Limitations

226. The European Communities supports the United States' appeal of the Panel's finding that planting flexibility limitations disqualify a measure from the coverage of paragraph 6 of Annex 2 of the *Agreement on Agriculture*. The European Communities notes that the United States has placed limitations on the crops that may be grown by farmers receiving production flexibility contract

payments and direct payments. In doing so, the United States ensures fair competition domestically and limits distortions internationally. If upheld, the Panel's findings would have the perverse effect of increasing subsidization and the likelihood of trade distortions.

227. The European Communities observes that paragraph 6(b) prevents the amount of the payments from being related to the type of production; it does not address eligibility for payments. With this in mind, the European Communities submits that "the fact of making ineligible for payments the land used to produce a certain commodity is not incompatible with paragraph 6(b)".<sup>175</sup> Furthermore, the Panel correctly noted that paragraphs 6(b) and 6(e) lay down distinct requirements and that each of them must be given meaning. The European Communities considers that the Panel's interpretation of paragraph 6(b) would render redundant paragraph 6(e). The Panel's reading is that any payment conditional upon a production requirement (which, as such, is incompatible with paragraph 6(e)) would be deemed to be "related to" the "volume" of production and would therefore be incompatible with paragraph 6(b). The European Communities argues that the Panel should not have relied upon paragraph 11 of Annex 2 because that provision appears in a context very different from that of the provisions of paragraph 6.

- (b) Article 13(a) of the *Agreement on Agriculture* – Base Period Update

228. With regard to Brazil's conditional cross-appeal regarding base period updates, the European Communities notes that the Panel made factual findings that there was no evidence to suggest that farmers expected further updates in future years. The European Communities does not consider that paragraph 6(a) of Annex 2 of the *Agreement on Agriculture* precludes adjustments to base periods, although it agrees with Brazil that a "defined and fixed" base period cannot be determined from the perspective of five-yearly subsidization legislation, but rather should be viewed in a longer-term perspective. The European Communities considers that it cannot be open to a Member to resort to wholesale updating of base periods by linking the criteria of "defined and fixed" to specific legislative packages.

- (c) Article 13(b) of the *Agreement on Agriculture*

229. The European Communities supports the United States' request for the Appellate Body to reverse the Panel's interpretation of Article 13(b) of the *Agreement on Agriculture*, particularly in respect to the methodology for calculating support and the meaning of "support to a specific commodity". With regard to the methodology, the European Communities agrees with the United States that the Panel should not have used budgetary outlays to calculate support "decided" in respect

<sup>175</sup>European Communities' third participant's submission, para. 15.

of price-based measures, but rather should have used price gap methodology. The European Communities contends that this approach is crucial for the interpretation of the specific term "decided", in contrast to the term "granted". The European Communities also agrees with the United States that the Panel was incorrect in finding that support under schemes based on historical production of specific crops could be considered "support to a specific commodity" in the implementation period in the sense of Article 13(b)(ii).

(d) Significant Price Suppression under Article 6.3(c) of the *SCM Agreement*

230. In relation to the United States' arguments regarding the quantification of subsidies, the European Communities agrees with Brazil that, in assessing significant price suppression under Article 6.3(c) of the *SCM Agreement*, it is not necessary to determine the precise amount of the subsidy or the amount of the benefit conferred on the subsidized product. This is consistent with the differences between Parts III and V of the *SCM Agreement*. Paragraph 7 of Annex IV of the *SCM Agreement*, to which the United States refers, is an exception to the general rule that a panel need not quantify or allocate a subsidy (other than a pre-WTO subsidy) to the products concerned.

231. The European Communities contests the United States' arguments regarding past "recurring" subsidies. Article 6.3(c) is drafted in the present tense and therefore should apply to the past, present, and future. The European Communities asserts that a subsidy comprises an act (a financial contribution) and that it may have an effect on the recipient (a benefit) and an effect on the market and other Members (adverse effects). However, the United States erroneously equates the concepts of "benefit" and "adverse effects". The subsidies challenged in the present dispute are programs that continue and that therefore may have adverse effects in the future, even if they confer a benefit in only one particular year. Therefore, the European Communities considers that the Panel correctly included past recurring subsidies in its analysis under Article 6.3(c). However, the European Communities maintains that it would have been "desirable"<sup>176</sup> for the Panel to distinguish between programs that had expired and programs that were still in force when the Panel was established.

(e) Relationship between the *Agreement on Agriculture* and the *SCM Agreement*

232. The European Communities raises an issue concerning the Panel's jurisdiction that it considers the Appellate Body should take up on its own motion. According to the European Communities, the *SCM Agreement* does not apply to domestic support and export subsidies in

respect of agricultural products because the *Agreement on Agriculture* contains "provisions dealing specifically with the same matter".<sup>177</sup>

(f) Step 2 Payments to Domestic Users

233. The European Communities agrees with the United States' claim that the Panel erred in finding that Step 2 payments to domestic users are inconsistent with Article 3.1(b) of the *SCM Agreement*. In addition to endorsing the arguments put forward by the United States, the European Communities argues that the Panel incorrectly sought an explicit carve out from Article 6.3 of the *Agreement on Agriculture* for import substitution subsidies, when such a carve out is unnecessary in the light of Article 21.1 of that Agreement and the introductory phrase of Article 3.1 of the *SCM Agreement*. The European Communities submits that paragraph 7 of Annex 3 of the *Agreement on Agriculture* recognizes that WTO Members have a right to provide import substitution subsidies. The Panel's interpretation to the contrary renders the language of paragraph 7 of Annex 3 redundant.

7. India

234. Pursuant to Rule 24 of the *Working Procedures*, India chose not to submit a third participant's submission. In its statement at the oral hearing, India disagreed with the United States that Brazil had to establish the amount of the price-contingent subsidies that benefit upland cotton in making its claim of serious prejudice under Articles 5(c) and 6.3 of the *SCM Agreement*.

8. New Zealand

(a) Article 13(a) of the *Agreement on Agriculture* – Base Period Update

235. New Zealand supports Brazil's contention that the direct payments under the FSRI Act of 2002 do not meet the criteria set out in paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*. According to New Zealand, the factual findings made by the Panel establish that direct payments cannot be green box payments because farmers had an opportunity to update base acreage, contrary to this provision. New Zealand notes that the language and context of paragraph 6(a) contemplate a single base period that is fixed and unchanging to ensure that such support is clearly de-linked from production. To conclude otherwise would create an internal inconsistency in paragraph 6, because a Member could avoid obligations under paragraphs 6(b), 6(c), and 6(d) not to link payments to production, prices, or factors of production employed in subsequent years, by establishing a new base period from time to time. New Zealand observes that the Panel found that the direct payment

<sup>176</sup>European Communities' third participant's submission, para. 61.

<sup>177</sup>European Communities' third participant's submission, para. 6 (quoting Appellate Body Report, *EC – Bananas III*, para. 155).

program is a successor to the production flexibility contract program and that the base period update had the effect of increasing the level of payments under the program.

(b) Article 13(b) of the *Agreement on Agriculture*

236. New Zealand contests the United States' appeal of the Panel's finding that the United States' measures at issue are not exempt from action pursuant to Article 13(b)(ii) of the *Agreement on Agriculture*. New Zealand argues that Members drafting the proviso to Article 13(b) were principally concerned with limiting the effect of domestic support measures on trade. New Zealand argues that the manner in which "support" is identified and calculated in the comparison required by Article 13(b)(ii) must reflect Members' intentions to limit the effects of such measures to those that existed in the 1992 marketing year and to ensure that measures are not exempt from actions when their effect is a significantly higher level of trade distortion in the implementation period than in the 1992 marketing year.

(i) *Calculation methodology for price-based measures*

237. New Zealand considers that the Appellate Body should uphold the Panel's finding that, on the facts of this case, budgetary outlays provide an appropriate measurement of support for the purposes of the comparison required by Article 13(b)(ii). New Zealand argues that a Member may not justify a failure to meet its obligations under the *Agreement on Agriculture* on the ground that it has adopted measures that rely on factors beyond the government's control. If a Member adopts a non-green box domestic support measure that determines the amount of support provided on the basis of factors the government cannot control, then the Member must accept the risk that support granted in the implementation period may be in excess of that decided in the 1992 marketing year. Furthermore, New Zealand disagrees with the argument advanced by the United States that only a price gap calculation can reflect support "decided" by the United States' price-based measures. New Zealand argues that this argument would read the term "grant" out of Article 13(b)(ii) altogether.

(ii) *Interpretation of "support to a specific commodity"*

238. New Zealand argues that the Appellate Body should reject the United States' argument that Article 13(b)(ii) of the *Agreement on Agriculture* requires a comparison of only "product-specific" support. For New Zealand, the chapeau of Article 13(b) makes it clear that the measures subject to the proviso of Article 13(b)(ii) are all "domestic support measures that conform fully to the provisions of Article 6" of the *Agreement on Agriculture* (that is, both product-specific and non-product-specific support to upland cotton). The use of the word "specific" in Article 13(b)(ii) refers only to the fact that the comparison is to be made on a commodity-by-commodity basis. In New Zealand's

view, the Panel correctly found that "support to a specific commodity" means all support to a commodity, whether product-specific or not. New Zealand also agrees with the Panel's finding that measures that "identify and allocate support based on an express linkage to specific commodities"<sup>178</sup> provide support to those commodities within the meaning of Article 13(b)(ii). Accordingly, even a measure that provides support to a number of different commodities also provides support to those specific commodities individually. New Zealand adds that not only do the words "product-specific support" not appear in Article 13(b)(ii), but the concept of product-specific support is not relevant to the comparison under this provision because Article 13(b)(ii) requires an analysis that is fundamentally different from that required under those provisions of the *Agreement on Agriculture* that distinguish between product-specific and non-product-specific support.

239. Finally, New Zealand disagrees with the United States' assertion that counter-cyclical payments and market loss assistance payments are "decoupled". As the Panel recognized, the amount of payment under these programs is clearly linked to current prices, which means that they cannot be green box measures in terms of Annex 2 of the *Agreement on Agriculture*.

(c) Significant Price Suppression under Article 6.3(c) of the *SCM Agreement*

240. New Zealand agrees with Brazil that the Panel correctly found that the effect of the price-contingent subsidies is significant price suppression within the meaning of Article 6.3(c), constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*.

241. New Zealand agrees with Brazil that the term "in the same market" in Article 6.3(c) can include a world market, although this does not preclude the possibility of other markets. New Zealand also agrees that, although a world market does not necessarily exist for every product, a world market and a world price do exist for upland cotton.

242. New Zealand submits that the Panel was correct in rejecting the United States' argument that the price-contingent subsidies did not suppress prices because, in the absence of these subsidies, new suppliers would have increased supply and maintained the world price. In response to the United States' arguments regarding the effect of the subsidies on the planting decisions of farmers, New Zealand argues that this effect is a key aspect of the Panel's analysis under Article 6.3(c), which led it to conclude that the subsidies insulated United States cotton producers from declines in world prices. Moreover, the Panel correctly found that the gap between total production costs and market revenue

<sup>178</sup>New Zealand's third participant's submission, para. 3.16 (quoting Panel Report, para. 7.484).

constituted evidence that the price-contingent subsidies enabled United States upland cotton producers to increase supply, leading to price suppression in the world market.

243. New Zealand agrees with Brazil that a panel is not required, in assessing significant price suppression under Article 6.3(c), to quantify precisely the amount of the subsidy. As the Panel found, claims under Parts III and V of the *SCM Agreement* differ, and the quantitative and pass-through methodologies applicable under Part V are not necessarily transferable to Part III. Although the magnitude of a subsidy may be relevant in some cases, it is not necessarily determinative of the nature or extent of the effects of the subsidy.

244. New Zealand disagrees with the United States' arguments regarding past recurring subsidies, which would effectively preclude Members from bringing claims of serious prejudice against recurring subsidies, even though payments under subsidy programs over an extended period can have effects in later years.

(d) World Market Share under Article 6.3(d) of the *SCM Agreement*

245. New Zealand supports Brazil's appeal of the Panel's finding that the "world market share" of the subsidizing Member under Article 6.3(d) refers to the share of the world market supplied by the subsidizing Member. Defining "world market share" as including all production, instead of only exports, distracts from the trade focus of the *SCM Agreement* and subverts the underlying rationale of Article 6.3(d). New Zealand supports Brazil's request for the Appellate Body to complete the analysis under Article 6.3(d).

(e) Export Credit Guarantees – Articles 10.1 and 10.2 of the *Agreement on Agriculture*

246. New Zealand asserts that the Panel was correct in finding that export credit guarantee programs are subject to the non-circumvention obligation under Article 10.1 of the *Agreement on Agriculture*, and that the United States' export credit guarantee programs provide export subsidies that breach Article 10.1 and are not exempt from action under the *SCM Agreement*. In New Zealand's view, Article 10.1 clearly applies to export credit guarantee programs that involve the granting of export subsidies. Article 10.2 does not create any exception that may contradict the clear meaning of Article 10.1. The United States' interpretation would create a loophole for WTO Members to circumvent their export subsidy reduction commitments through export credit guarantee programs. In such a case, New Zealand observes that Article 10.2 would, itself, circumvent the anti-circumvention provisions.

(f) Export Credit Guarantees – Articles 1 and 3.1(a) of the *SCM Agreement*

247. New Zealand agrees with Brazil that the Panel erred in exercising judicial economy by refusing to make a finding relating to the United States' export credit guarantee programs under Articles 1.1 and 3.1(a) of the *SCM Agreement*. In New Zealand's view, a measure that no longer constitutes an export subsidy under item (j) of the Illustrative List of Export Subsidies may still constitute an export subsidy under Articles 1.1 and 3.1(a) of the *SCM Agreement*. Therefore, New Zealand requests the Appellate Body to complete the analysis and find that the United States' export credit guarantee programs are export subsidies under Articles 1.1 and 3.1(a) of the *SCM Agreement*.

9. Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu

248. Pursuant to Rule 24 of the *Working Procedures*, the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu chose not to submit a third participant's submission. In its statement at the oral hearing, the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu agreed with the United States that using planting flexibility limitations in association with production flexibility contract payments and direct payments does not render these measures inconsistent with paragraph 6(b) of Annex 2 to the *Agreement on Agriculture*.

### III. Issues Raised in this Appeal

249. The following issues are raised in this appeal:

(a) as regards procedural matters:

(i) in relation to production flexibility contract payments and market loss assistance payments:

- whether the Panel erred in finding, in paragraphs 7.118, 7.122, 7.128, and 7.194(ii) of the Panel Report, that Articles 4.2 and 6.2 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU") do not exclude expired measures from the potential scope of consultations or a request for establishment of a panel and, therefore, that production flexibility contract payments and market loss assistance payments fell within the Panel's terms of reference; and

- whether the Panel, contrary to Article 12.7 of the DSU, failed to set out the findings of fact, the applicability of relevant provisions, or the basic rationale behind this finding; and
- (ii) in relation to export credit guarantee programs:
  - whether the Panel erred in finding, in paragraph 7.69 of the Panel Report, that the United States' export credit guarantees relating to eligible United States agricultural commodities other than upland cotton were within its terms of reference; and
  - whether the Panel erred in finding, in paragraph 7.103 of the Panel Report, that Brazil provided a statement of available evidence with respect to export credit guarantees relating to eligible United States agricultural commodities other than upland cotton, as required by Article 4.2 of the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*");

(b) as regards the application of Article 13 of the *Agreement on Agriculture* to this dispute:

- (i) in relation to Article 13(a)(ii):
  - whether the Panel erred in finding, in paragraphs 7.388, 7.413, 7.414, and 8.1(b) of the Panel Report, that production flexibility contract payments and direct payments are not green box measures that fully conform to paragraph 6(b) of Annex 2 of the *Agreement on Agriculture* based on its finding, in paragraph 7.385 of the Panel Report, that the amount of production flexibility payments and direct payments is related to the type of production undertaken by a producer after the base period; and, therefore, that these measures are not exempt from actions based on Article XVI of the *General Agreement on Tariffs and Trade 1994* (the "*GATT 1994*") and Part III of the *SCM Agreement* by virtue of Article 13(a)(ii) of the *Agreement on Agriculture*; and
- whether the updating of base acres for direct payments under the FSR1 Act of 2002 means that direct payments are not green box

measures that fully conform to paragraph 6(a) of Annex 2 of the *Agreement on Agriculture* and, therefore, that these measures are not exempt from actions based on Article XVI of the GATT 1994 and Part III of the *SCM Agreement* by virtue of Article 13(a)(ii) of the *Agreement on Agriculture*, because they are not determined by clearly-defined criteria in a *defined and fixed base period*<sup>179</sup>; and

- (ii) in relation to Article 13(b)(ii), whether the Panel erred in finding, in paragraphs 7.608 and 8.1(c) of the Panel Report, that user marketing (Step 2) payments ("Step 2 payments") to domestic users, marketing loan program payments, production flexibility contract payments, market loss assistance payments, direct payments, counter-cyclical payments, crop insurance payments, and cottonseed payments (the "challenged domestic support measures") granted, in the years 1999, 2000, 2001, and 2002, support to a specific commodity, namely, upland cotton, in excess of that decided during the 1992 marketing year and, therefore, that these measures are not exempt from actions based on Articles 5 and 6 of the *SCM Agreement* and Article XVI:1 of the GATT 1994 by virtue of Article 13(b)(ii) of *Agreement on Agriculture*, based on its findings:

- in paragraph 7.494 of the Panel Report, that the phrase "grant support to a specific commodity" in Article 13(b)(ii) refers to all non-green box support measures that clearly or explicitly define a commodity as one to which they bestow or confer support and does not mean "product-specific domestic support";
- in paragraphs 7.518 and 7.520 of the Panel Report, that the challenged domestic support measures are non-green box support measures that clearly or explicitly define a commodity, namely, upland cotton, as one to which they bestow or confer support; and
- in paragraphs 7.561 and 7.562 of the Panel Report, that an appropriate comparison between the level at which measures "grant support" in the implementation period and that "decided during

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<sup>179</sup>Brazil's appeal is conditional on the Appellate Body reversing the finding of the Panel that "direct payments, production flexibility contract payments, and the legislative and regulatory provisions that establish and maintain the direct payment program" do not fully conform to paragraph 6(b) of Annex 2 and, consequently, do not satisfy the condition in paragraph (a) of Article 13 of the *Agreement on Agriculture*.

the 1992 marketing year" may be achieved, with respect to marketing loan program payments and deficiency payments, through the use of a methodology other than the price gap methodology described in paragraph 10 of Annex 3 of the *Agreement on Agriculture*;

- (c) as regards serious prejudice:
  - (i) in relation to Article 6.3(c) of the *SCM Agreement*:
    - whether the Panel erred in finding, in paragraphs 7.1416 and 8.1(g)(i) of the Panel Report, that the effect of the marketing loan program payments, Step 2 payments, market loss assistance payments, and counter-cyclical payments (the "price-contingent subsidies") is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*, based on its findings:
      - (A) regarding the "market" and "price" in assessing whether "the effect of the subsidy is ... significant price suppression ... in the same market" within the meaning of Article 6.3(c) of the *SCM Agreement*:
        - in paragraphs 7.1238-7.1240 of the Panel Report, that the "same market" may be a "world market";
        - in paragraph 7.1247 of the Panel Report, that a "world market" for upland cotton exists; and
        - in paragraph 7.1274 of the Panel Report, that "the A-Index can be taken to reflect a world price in the world market for upland cotton"; and
      - (B) regarding the "effect" of the price-contingent subsidies under Article 6.3(c) of the *SCM Agreement*:
        - in paragraphs 7.1312 and 7.1333 of the Panel Report, that "significant price suppression" occurred within the meaning of Article 6.3(c);

- in paragraphs 7.1355 and 7.1363 of the Panel Report, that "a causal link exists" between the price-contingent subsidies and the significant price suppression found by the Panel under Article 6.3(c) and that this link is not attenuated by other factors raised by the United States;
- in paragraphs 7.1173, 7.1186, and 7.1226 of the Panel Report, that it was not required to quantify precisely the benefit conferred on upland cotton by the price-contingent subsidies and, consequently, not identifying the precise amount of counter-cyclical payments and market loss assistance payments that benefited upland cotton; and
- in paragraph 7.1416 of the Panel Report, that the effect of the price-contingent subsidies for marketing years 1999 to 2002 "is significant price suppression ... in the period MY 1999-2002"; and
- whether the Panel, contrary to Article 12.7 of the DSU, failed to set out the findings of fact, the applicability of relevant provisions, or the basic rationale behind its finding, in paragraphs 7.1416 and 8.1(g)(i) of the Panel Report, that the effect of the price-contingent subsidies is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*; and
- (ii) in relation to Article 6.3(d) of the *SCM Agreement*:
  - whether the Panel erred in finding, in paragraph 7.1464 of the Panel Report, that the words "world market share" in Article 6.3(d) of the *SCM Agreement* refer to the "share of the world market supplied by the subsidizing Member of the product concerned"; and
  - whether the Appellate Body should complete the analysis of whether the effect of the price-contingent subsidies is an increase in the

United States' world market share of exports in upland cotton within the meaning of Article 6.3(d) of the *SCM Agreement*<sup>180</sup>;

- (d) as regards user marketing (Step 2) payments, whether the Panel erred:
- (i) in finding, in paragraphs 7.1088, 7.1097-7.1098, and 8.1(f) of the Panel Report, that Step 2 payments to *domestic users* of United States upland cotton, under Section 1207(a) of the FSRI Act of 2002, are subsidies contingent upon the use of domestic over imported goods that are inconsistent with Articles 3.1(b) and 3.2 of the *SCM Agreement*; and
  - (ii) in finding, in paragraphs 7.748-7.749, 7.760-7.761, and 8.1(c) of the Panel Report, that Step 2 payments to *exporters* of United States upland cotton, pursuant to Section 1207(a) of the FSRI Act of 2002, are subsidies contingent upon export performance within the meaning of Article 9.1(a) of the *Agreement on Agriculture* that are inconsistent with Articles 3.3 and 8 of that Agreement and Articles 3.1(a) and 3.2 of the *SCM Agreement*;
- (e) as regards export credit guarantee programs, whether the Panel erred:
- (i) in finding, in paragraphs 7.901, 7.911, and 7.932 of the Panel Report, that Article 10.2 of the *Agreement on Agriculture* does not exempt export credit guarantees from the export subsidy disciplines in Article 10.1 of that Agreement;
  - (ii) in the manner that it applied the burden of proof in finding that the United States' export credit guarantee programs are prohibited export subsidies under Articles 3.1(a) and 3.2 of the *SCM Agreement*;
  - (iii) by failing to make the necessary findings of fact in assessing whether the United States' export credit guarantee programs are provided at premium rates that are inadequate to cover long-term operating costs and losses within the meaning of item (j) of the Illustrative List of Export Subsidies annexed to the *SCM Agreement*;

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<sup>180</sup>Brazil's request for the Appellate Body to complete the analysis of this issue is conditional on the Appellate Body reversing the finding of the Panel that the effect of the price-contingent subsidies was significant price suppression in terms of Article 6.3(c) of the *SCM Agreement*.

- (iv) in finding, in paragraphs 7.947 and 7.948 of the Panel Report, that the United States' export credit guarantee programs are prohibited export subsidies under Article 3.1(a) of the *SCM Agreement* and are consequently inconsistent with Article 3.2 of that Agreement; and
- (v) by exercising judicial economy, as noted in paragraph 6.31 of the Panel Report, in respect of Brazil's claim that the United States' export credit guarantee programs are export subsidies within the meaning of Articles 1.1 and 3.1(a) of the *SCM Agreement*, having already found that these measures were export subsidies covered by item (j) of the Illustrative List of Export Subsidies and, therefore, were inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*;
- (f) as regards circumvention of export subsidy commitments, whether the Panel erred:
  - (i) in the application of Article 10.1 of the *Agreement on Agriculture* and by failing to meet the requirements of Article 11 of the DSU, in finding, in paragraph 7.881 of the Panel Report, that Brazil did not establish that the United States' export credit guarantees are "applied in a manner that results in ... circumvention" of the United States' export subsidy commitments with respect to pig meat and poultry meat in 2001<sup>181</sup>;
  - (ii) in paragraphs 7.882-7.883 and 7.896 of the Panel Report, in interpreting and applying the phrase "threatens to lead to ... circumvention" in Article 10.1 of the *Agreement on Agriculture*; and
  - (iii) in paragraph 7.882 and footnote 1061 of the Panel Report, by confining its examination of threat of circumvention to scheduled products other than rice and unsupported unscheduled products;
- (g) as regards the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 (the "ETI Act of 2000"), whether the Panel erred in finding that Brazil did not establish a *prima facie* case that the ETI Act of 2000 and the subsidies granted

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<sup>181</sup>At the oral hearing, Brazil indicated that it was not pursuing this claim in respect of vegetable oil.

thereunder are inconsistent with Articles 8 and 10.1 of the *Agreement on Agriculture* and Articles 3.1 and 3.2 of the *SCM Agreement*, in respect of upland cotton; and

(h) as regards Article XVI:3 of the GATT 1994:

- (i) whether the Panel erred in finding, in paragraph 7.1016 of the Panel Report, that Article XVI:3 of the GATT 1994 "applies only to export subsidies as that term is now defined in the *Agreement on Agriculture* and the *SCM Agreement*"; and
- (ii) whether the Appellate Body should complete the analysis of whether the price-contingent subsidies caused the United States to have "more than an equitable share of world export trade" in upland cotton, in violation of the second sentence of Article XVI:3 of the GATT 1994.<sup>182</sup>

#### IV. Preliminary Issues

##### A. *Terms of Reference – Expired Measures*

###### 1. Introduction

250. The United States appeals the Panel's finding that two subsidy measures, namely, production flexibility contract payments with the exception of those made in the 2002 marketing year and market loss assistance payments, can be the subject of consultations under the DSU and hence fell within the Panel's terms of reference, notwithstanding the fact that the legislative basis for these payments had expired at the time those terms of reference were set.<sup>183</sup>

251. Production flexibility contract payments were a form of income support under the Federal Agriculture Improvement and Reform Act of 1996 (the "FAIR Act of 1996"); they were discontinued with the passage of the Farm Security and Rural Investment Act of 2002 (the "FSRI Act of 2002") in May 2002. The last production flexibility contract payments were scheduled to be made "not later

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<sup>182</sup>Brazil's request for the Appellate Body to complete the analysis of this issue is conditional on two events: (i) the Appellate Body reversing the finding of the Panel that the effect of the price-contingent subsidies was significant price suppression in terms of Article 6.3(c) of the *SCM Agreement*; and, (ii) the Appellate Body declining Brazil's request for a ruling that the United States' measures at issue resulted in an increase in the United States' world market share in upland cotton in terms of Article 6.3(d) of the *SCM Agreement*.

<sup>183</sup>Notwithstanding paragraph 9 of the United States' Notice of Appeal, the United States explained during the oral hearing that it does not appeal the Panel's finding, in paragraph 7.132 of the Panel Report, that payments with respect to non-upland cotton base acres were within its terms of reference.

than" 30 September 2002<sup>184</sup>, in connection with the 2002 crop. Market loss assistance payments were *ad hoc* annual payments made through legislation enacted by the United States Congress between 1998 and 2001. Each such payment was made through a separate piece of legislation, the last of which was enacted on 13 August 2001, for the marketing year 2001 (1 August 2001 – 31 July 2002) crop.<sup>185</sup>

252. Before the Panel, the United States argued that production flexibility contract payments and market loss assistance payments could not be within the terms of reference because they had expired prior to Brazil's request for consultations. The United States argued that Article 4.2 of the DSU provides that consultations may cover only "measures affecting" the operation of a covered agreement, and that expired measures are not "measures affecting" the operation of a covered agreement.<sup>186</sup> Brazil asked the Panel to reject the United States' request, submitting that a panel is required to examine the effects flowing from expired measures in order to conduct an objective assessment of a serious prejudice claim.<sup>187</sup>

253. The Panel noted that Brazil had not pursued claims with respect to the legislation underlying the programs; instead, Brazil's claim was limited to the WTO-consistency of the payments made under those programs.<sup>188</sup> In its reasoning, the Panel said it did:

... not consider that Article 4.2 [of the DSU] supports an interpretation that a request for consultations cannot concern measures that have expired, or payments made under programmes that are no longer in effect, where the Member requesting consultations represents that benefits accruing to it directly or indirectly under the covered agreements are being impaired by those measures.<sup>189</sup>

254. It added that "the Panel's terms of reference refer to Brazil's request for establishment of a panel, not its request for consultations."<sup>190</sup> The Panel also recalled that "Article 6.2 of the *DSU* provides that a request for establishment of a panel should identify the 'specific measures at issue' and

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<sup>184</sup>See Panel Report, paras. 7.107 and 7.212-7.215. See also "Answers of the United States to the Panel's Questions Posed Following the First Session of the First Substantive Panel Meeting" (11 August 2003), Panel Report, p. 1-84, para. 35.

<sup>185</sup>For further discussion of the nature of production flexibility contract payments and market loss assistance payments, insofar as they are relevant to this issue, see Panel Report, paras. 7.107 and 7.212-7.217.

<sup>186</sup>See Panel Report, paras. 7.104 and 7.113.

<sup>187</sup>See Panel Report, para. 7.105.

<sup>188</sup>*Ibid.*, para. 7.108.

<sup>189</sup>*Ibid.*, para. 7.118.

<sup>190</sup>*Ibid.*, para. 7.121.

does not address the issue of the status of the measures at all.<sup>191</sup> On this basis, the Panel indicated that it did not believe that:

Article 4.2, and hence Article 6.2, of the *DSU* excludes expired measures from the potential scope of a request for establishment of a panel.<sup>192</sup>

255. In the light of this finding (and having rejected a further claim by the United States that market loss assistance payments were not identified with adequate specificity in Brazil's request for establishment of a panel<sup>193</sup>), the Panel concluded:

Therefore, in light of our conclusion at paragraph 7.122, ... the Panel rules that PFC and MLA payments, as addressed in document WT/DS267/7, fall within its terms of reference.<sup>194</sup>

2. Appeal by the United States

256. The United States claims that the Panel erred in reaching this conclusion and requests the Appellate Body to reverse the Panel's finding that Articles 4.2 and 6.2 of the *DSU* do not exclude expired measures from the potential scope of consultations or a request for establishment of a panel.<sup>195</sup> It also asserts that the Panel failed to set out the findings of fact, the applicability of relevant provisions, and the basic rationale behind this finding, as required by Article 12.7 of the *DSU*.<sup>196</sup> The United States submits that it was undisputed that the legislation authorizing both of these types of payments had expired before Brazil submitted its request for consultations.<sup>197</sup>

257. The United States observes that Article 4.2 of the *DSU* provides that consultations may cover "any representations made by another Member concerning measures affecting the operation of any covered agreement taken within the territory of the former".<sup>198</sup> The United States focuses on the present tense of the verb "affecting" in this Article and contends that expired measures cannot be

<sup>191</sup> Panel Report, para. 7.121.

<sup>192</sup> *Ibid.*, para. 7.122.

<sup>193</sup> *Ibid.*, para. 7.127. This finding has not been appealed.

<sup>194</sup> *Ibid.*, para. 7.128. This final finding was reiterated in paragraph 7.194(ii) of the Panel Report.

<sup>195</sup> United States' Notice of Appeal, *supra*, footnote 17, para. 14; United States' appellant's submission, para. 515.

<sup>196</sup> United States' appellant's submission, para. 150.

<sup>197</sup> *Ibid.*, para. 500.

<sup>198</sup> United States' appellant's submission, para. 501 (quoting Article 4.2 of the *DSU*). (emphasis added by the United States)

measures "affecting", in the present, the operation of a covered agreement.<sup>199</sup> Thus, according to the United States, production flexibility contract and market loss assistance payments cannot be said to be currently "affecting" the operation of any covered agreement. Consequently, they cannot be measures falling within the scope of "specific measures at issue" in terms of Article 6.2 of the *DSU*.<sup>200</sup>

258. Brazil responds that neither Article 4.2 nor Article 6.2 of the *DSU* precludes a panel from analyzing payments made in the past in the context of serious prejudice claims. Brazil focuses on the context provided by Article 3.3 of the *DSU*, which states that a purpose of dispute settlement is the "prompt settlement of situations in which a Member considers that any benefits accruing to it ... are being impaired by measures taken by another Member". For Brazil, as long as the impairment is *current*, the status in domestic law of the measure causing that impairment is irrelevant. Brazil notes that the present dispute involves allegations of "adverse effects" and "serious prejudice" under the provisions of the *SCM Agreement* and the GATT 1994. A breach of the relevant provisions of these Agreements does not occur when an actionable subsidy is granted, but rather when the adverse effects arise. Brazil finds support for its position in the view of the panel in *Indonesia – Autos*, which found that past, present, and future subsidies can be the subject of dispute settlement, as the effect of such measures may be serious prejudice to the interests of a Member.<sup>201</sup>

3. Scope of Consultations under Article 4.2 of the DSU

259. Article 4.2 of the *DSU* governs what measures may be the subject of consultations and provides as follows:

Each Member undertakes to accord sympathetic consideration to and afford adequate opportunity for consultation regarding any representations made by another Member concerning measures affecting the operation of any covered agreement taken within the territory of the former. (footnote omitted)

260. It is clear from Article 4.2 that, although a requested Member is under an obligation to engage in "consultation" on "any" representations made by another Member, such representations must pertain to "measures affecting the operation of any covered agreement". The United States argues that Article 4.2 of the *DSU* limits the obligation of the requested Member to representations concerning measures that are actually "*affecting*" the operation of any covered agreement. The United States stresses the temporal significance of the present tense of the word "affecting" and asserts that

<sup>199</sup> *Ibid.*, para. 501.

<sup>200</sup> United States' appellant's submission, paras. 502 and 512.

<sup>201</sup> Brazil's appellee's submission, para. 256 (referring to Panel Report, *Indonesia – Autos*, para. 14.206).

"[m]easures that have expired before a request for consultations *cannot* be measures 'affecting the operation of any covered agreement' at the time the request is made".<sup>202</sup>

261. We agree with the Panel that the word "affecting" refers primarily to "the way in which [measures] relate to a covered agreement".<sup>203</sup> As the Appellate Body stated in *EC – Bananas III*, "[t]he ordinary meaning of the word 'affecting' implies a measure that has 'an effect on'" something else.<sup>204</sup> At the same time, we also concur with the United States that the ordinary meaning of the word "affecting" suggests a temporal connotation. As the United States submits, the present tense of the phrase "affecting the operation of any covered agreement" denotes that the effects of such measures must relate to the present impact of those measures on the operation of a covered agreement. It is not sufficient that a Member alleges that challenged measures affected the operation of a covered agreement in the past; the representations of the Member requesting consultations must indicate that the effects are occurring in the present.<sup>205</sup>

262. Whether or not a measure is still in force is not dispositive of whether that measure is currently affecting the operation of any covered agreement. Therefore, we disagree with the United States' argument that measures whose legislative basis has expired are incapable of affecting the operation of a covered agreement in the present and that, accordingly, expired measures *cannot* be the subject of consultations under the DSU.<sup>206</sup> In our view, the question of whether measures whose legislative basis has expired affect the operation of a covered agreement currently is an issue that must be resolved on the facts of each case. The outcome of such an analysis cannot be prejudged by excluding it from consultations and dispute settlement proceedings altogether.

263. We consider that requesting Members should enjoy a degree of discretion to identify, in their request for consultations under Article 4.2, matters relating to the covered agreements for discussion in consultations. As the Appellate Body observed in *Mexico – Corn Syrup (Article 21.5 – US)*, consultations present an opportunity for clarifying factual and legal issues, and for narrowing the scope of a dispute, and for resolving differences between WTO Members.<sup>207</sup> We do not think it would advance the purpose of consultations if Article 4.2 were interpreted as excluding *a priori* measures whose legislative basis may have expired, but whose effects are alleged to be impairing the benefits accruing to the requesting Member under a covered agreement. Nor, indeed, do we find

<sup>202</sup>United States' appellant's submission, para. 501. (emphasis added)

<sup>203</sup>Panel Report, para. 7.115.

<sup>204</sup>Appellate Body Report, *EC – Bananas III*, para. 220.

<sup>205</sup>This does not exclude the possibility that the effects of a measure may occur in future.

<sup>206</sup>United States appellant's submission, para. 501.

<sup>207</sup>Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 54.

textual support in the provision itself for doing so. Thus, we do not read Article 4.2 of the DSU as precluding a Member from making representations on measures whose legislative basis has expired, where that Member has reason to believe that such measures are still "affecting" the operation of a covered agreement.

264. We find contextual support for this interpretation in Article 3.3 of the DSU<sup>208</sup>, which underscores the importance of the "prompt settlement" of certain situations that, in the absence of settlement, could undermine the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members. We note, first, that Article 3.3 focuses not upon "existing" measures, or measures that are "currently in force" but, rather, upon "measures taken" by a Member, which includes measures taken in the past.<sup>209</sup> We also observe that Article 3.3 envisages that disputes arise when a Member "considers" that benefits accruing to it are being impaired by measures taken by another Member. By using the word "considers", Article 3.3 focuses on the perception or understanding of an aggrieved Member. This does not exclude the possibility that a Member requesting consultations may have reason to believe that a measure is still impairing benefits even though its legislative basis has expired.<sup>210</sup>

265. We recall that the Panel observed that:

Brazil's request for consultations alleges that the use of the measures specified in the request "causes adverse effects, i.e. serious prejudice" to its interests. We note the present tense of this allegation. The request concerns the way in which measures were affecting the operation of a covered agreement at the time of consultations, and it states that Brazil had reason to believe that these subsidies were resulting in serious prejudice at that time.<sup>211</sup>

<sup>208</sup>Article 3.3 of the DSU provides:

The prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is essential to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members.

<sup>209</sup>Indeed, as the Panel noted, in the sense that "PFC and MLA payments had already been made at the date of the establishment of the Panel", "they had not expired, but had simply occurred in the past". (Panel Report, para. 7.110)

<sup>210</sup>Whether the Member's belief proves to be correct is a substantive matter to be addressed in the consultations, or—if consultations fail—before a panel. We note that Brazil's request for consultations in regard to this matter was based not only on Article 4 of the DSU, but also on Article 7.1 of the *SCM Agreement* (as well as Article XXII of the GATT 1994). (See Request for Consultations by Brazil, WT/DS267/1, 3 October 2002, p. 1.) Article 7.1 authorizes a Member to request consultations whenever it "has reason to believe" that any subsidy referred to in Article 1 "results in" certain effects listed in that provision. Article 7.1 thus recognizes that questions regarding the results of subsidization are potentially contentious matters.

<sup>211</sup>Panel Report, para. 7.119.

266. For the Panel, these aspects of the request for consultations were sufficient for Brazil to meet the requirements of Article 4.2 of the DSU. We see no error in the Panel's approach to this question. Whether or not a subsidy program is still in force at the time consultations were requested does not answer the question whether any payments previously made under that program are currently affecting the operation of a covered agreement in the sense of Article 4.2. Brazil, in these proceedings, represented in its request for consultations that payments under the production flexibility contract and market loss assistance programs continued to affect its rights under the *SCM Agreement*. In our view, this was sufficient to meet the requirements of Article 4.2 of the DSU.

4. Measure at Issue under Article 6.2 of the DSU

267. In addition to its arguments under Article 4.2 of the DSU, the United States contends that an expired measure cannot be a measure that is "at issue" in terms of Article 6.2 of the DSU. The United States also argues that a finding to the contrary would be difficult to reconcile with the terms of Articles 3.7 and 19.1 of the DSU, which contemplate the "withdrawal" of a measure found to be inconsistent with the covered agreements, or a recommendation that a measure found to be inconsistent with a covered agreement be brought into conformity. The United States argues that the remedies described in Articles 3.7 and 19.1 are essentially prospective in nature.

268. We understand these arguments by the United States to be largely dependent upon its arguments regarding Article 4.2 of the DSU: if, as the United States contends, a measure may not be the subject of consultations then, *ipso facto*, it may not be a measure "at issue" in the sense of Article 6.2. Having rejected the United States' arguments regarding Article 4.2, we do not find the United States' additional arguments under Article 6.2 compelling.

269. The only temporal connotation contained in the ordinary meaning of the expression "at issue", as used in Article 6.2 of the DSU, is expressed by its present tense: measures must be "at issue"—or, putting it another way, "in dispute"—at the time the request is made. Certainly, nothing inherent in the term "at issue" sheds light on whether measures at issue must be currently in force, or whether they may be measures whose legislative basis has expired.

270. The relevant context for Article 6.2 in this regard includes Articles 3.3 and 4.2 of the DSU. As we have concluded above, those provisions do not preclude a Member from making representations with respect to measures whose legislative basis has expired, if that Member considers, with reason, that benefits accruing to it under the covered agreements are still being impaired by those measures. If the effect of such measures remains in dispute following consultations, the complaining party may, according to Article 4.7 of the DSU, request the

establishment of a panel, and the text of Article 6.2 does not suggest that such measures could not be the subject of a panel request as "specific measures at issue".

271. The United States purports to find support for its position in the ruling of the Appellate Body in *US – Certain EC Products*, where the Appellate Body reversed the panel's decision to make a recommendation under Article 19.1 of the DSU that the United States bring the measure at issue in that case (the "3 March Measure") into conformity with the covered agreements, on the grounds that the panel had already found that the measure had expired. However, that case involved a situation different from the present one. There, the 3 March Measure had been the subject of consultations, but had expired. The expiry of the 3 March Measure did not prevent it being a "measure at issue" for purposes of Article 6.2 of the DSU. Indeed, neither the panel nor the Appellate Body found that the 3 March Measure was outside the panel's terms of reference, and both the panel and Appellate Body addressed that measure in their rulings.<sup>212</sup>

272. The question whether an expired measure is susceptible to a recommendation under Article 19.1 of the DSU is a different matter. The Appellate Body in *US – Certain EC Products* confirmed that the 3 March Measure had ceased to exist. It noted that there was an obvious inconsistency between the finding of the panel that "the 3 March Measure is no longer in existence" and the panel's subsequent recommendation that the Dispute Settlement Body (the "DSB") request the United States to bring the 3 March Measure into conformity with its WTO obligations.<sup>213</sup> Thus, the fact that a measure has expired may affect what recommendation a panel may make. It is not, however, dispositive of the preliminary question of whether a panel can address claims in respect of that measure.<sup>214</sup>

<sup>212</sup>This contrasts with the treatment of the other measure raised in that proceeding (the "19 April action"). It was in force, but had not been the subject of consultations. The panel and Appellate Body both ruled that the absence of consultations on the 19 April action required its exclusion from the terms of reference. (Appellate Body Report, *US – Certain EC Products*, para. 82; Panel Report, *US – Certain EC Products*, paras. 6.89 and 6.128)

<sup>213</sup>Appellate Body Report, *US – Certain EC Products*, paras. 81-82.

<sup>214</sup>This conclusion is consistent with the approach taken by GATT and WTO panels to questions relating to the expiry of measures after the initiation of dispute settlement proceedings, but before those proceedings have been completed. See, for example, GATT Panel Report, *EEC – Apples I (Chile)*, paras. 2.4 and 4.1 ff; Panel Report, *India – Autos*, para. 7.29. GATT and WTO panels have frequently made findings with respect to measures withdrawn after the establishment of the panel. See, for example, GATT Panel Report, *EEC – Animal Feed Proteins*, para. 2.4; GATT Panel Report, *US – Canadian Tuna*, para. 4.3; Panel Report, *US – Wool Shirts and Blouses*, para. 6.2; and Panel Report, *Indonesia – Autos*, para. 14.9. Even in cases where a panel has chosen not to rule on measures that had been terminated during the course of proceedings, panels have recognized that "[o]n several occasions, panels have considered measures that were no longer in force". (Panel Report, *Argentina – Textiles and Apparel*, para. 6.12. (footnote omitted)) In none of these cases has a panel or the Appellate Body premised its decision on the view that, *a priori*, an expired measure could not be within a panel's terms of reference.

273. It is important to recognize the particular characteristics of *subsidies* and the nature of Brazil's claims against the production flexibility contract and market loss assistance subsidy payments. Article 7.8 of the *SCM Agreement* provides that, where it has been determined that "any subsidy has *resulted* in adverse effects to the interests of another Member", the subsidizing Member must "take appropriate steps to *remove the adverse effects* or ... withdraw the subsidy". (emphasis added) The use of the word "resulted" suggests that there could be a time-lag between the payment of a subsidy and any consequential adverse effects.<sup>215</sup> If expired measures underlying past payments could not be challenged in WTO dispute settlement proceedings, it would be difficult to seek a remedy for such adverse effects. Further—in contrast to Articles 3.7 and 19.1 of the DSU—the remedies under Article 7.8 of the *SCM Agreement* for adverse effects of a subsidy are (i) the withdrawal of the subsidy or (ii) the removal of adverse effects. Removal of adverse effects through actions other than the withdrawal of a subsidy could not occur if the expiration of a measure would automatically exclude it from a panel's terms of reference.

274. For these reasons, we find the United States' reliance upon the prospective character of the remedies described in Articles 3.7 and 19.1 of the DSU unconvincing. We therefore *reject* the United States' argument that production flexibility contract payments and market loss assistance payments were outside the Panel's terms of reference by virtue of Article 6.2 of the DSU.

5. Article 12.7 of the DSU

275. The United States also alleges that, contrary to Article 12.7 of the DSU, the Panel failed to set out the findings of fact, the applicability of relevant provisions, and the basic rationale behind its finding that Articles 4.2 and 6.2 of the DSU do not exclude expired measures from the potential scope of a request for the establishment of a panel.

276. The Appellate Body stated in *Mexico – Corn Syrup (Article 21.5 – US)*:

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<sup>215</sup>We observe, in this regard, that the United States concedes that at least *some* subsidies can have effects for years after the date on which they are paid. Thus, the United States distinguishes between "non-recurring" subsidies and "recurring" subsidies. Although the United States believes that the effects of recurring subsidies are limited to the year for which they are paid, the United States *accepts* that the effects of non-recurring subsidies may spread out well into the future. (United States' appellant's submission, para. 508)

Article 12.7 establishes a minimum standard for the reasoning that panels must provide in support of their findings and recommendations. Panels must set forth explanations and reasons sufficient to disclose the essential, or fundamental, justification for those findings and recommendations.<sup>216</sup>

The Appellate Body clarified:

[w]hether a panel has articulated adequately the "basic rationale" for its findings and recommendations must be determined on a case-by-case basis, taking into account the facts of the case, the specific legal provisions at issue, and the particular findings and recommendations made by a panel. Panels must identify the relevant facts and the applicable legal norms. In applying those legal norms to the relevant facts, the reasoning of the panel must reveal how and why the law applies to the facts. In this way, panels will, in their reports, disclose the essential or fundamental justification for their findings and recommendations.<sup>217</sup>

The Appellate Body also explained that this "does not, however, necessarily imply that Article 12.7 requires panels to expound at length on the reasons for their findings and recommendations."<sup>218</sup>

277. We note that compliance with Article 12.7 of the DSU is to be determined on a case-by-case basis. With regard to the current proceedings, as discussed above, we see no error in the Panel's conclusion regarding its ability to make findings with respect to subsidies whose legislative basis had expired at the time of panel establishment. Although the Panel's reasoning with respect to this issue may be brief, the Panel set out the necessary findings of fact, the applicability of relevant provisions, and the basic rationale behind its findings. The Panel noted that the parties agreed on the key factual element that was relevant to this part of its analysis, namely, that the legislation under which production flexibility contract and market loss assistance payments were made had expired, and went

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<sup>216</sup>Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 106. It also noted that:

... the duty of panels under Article 12.7 of the DSU to provide a "basic rationale" reflects and conforms with the principles of fundamental fairness and due process that underlie and inform the provisions of the DSU. In particular, in cases where a Member has been found to have acted inconsistently with its obligations under the covered agreements, that Member is entitled to know the reasons for such finding as a matter of due process. In addition, the requirement to set out a "basic rationale" in the panel report assists such Member to understand the nature of its obligations and to make informed decisions about: (i) what must be done in order to implement the eventual rulings and recommendations made by the DSB; and (ii) whether and what to appeal.

(*Ibid.*, para. 107) (footnote omitted)

<sup>217</sup>*Ibid.*, para. 108.

<sup>218</sup>*Ibid.*, para. 109.

on to discuss relevant factual aspects.<sup>219</sup> The Panel cited and discussed Article 4.2, in particular the meaning and significance of the term "affecting" in that provision.<sup>220</sup> As we have done, the Panel interpreted Article 4.2 in the light of the context provided by Article 3.3 of the DSU.<sup>221</sup> It addressed Article 6.2 of the DSU<sup>222</sup>, and also situated the question of "expired measures" in the context of the actionable subsidies claims made by Brazil in this case.<sup>223</sup> Given these inquiries and considerations by the Panel, we see no reason to find that the Panel failed to meet the requirements of Article 12.7 of the DSU in relation to whether the expired production flexibility contract and market loss assistance payments fell within its terms of reference.

B. *Terms of Reference – Export Credit Guarantees*

1. Introduction

278. We turn now to the United States' claim that the Panel erred in finding that its terms of reference were not limited to export credit guarantees to upland cotton, but also included export credit guarantees to other eligible United States agricultural commodities.<sup>224</sup>

279. The United States requested the Panel to "rule that export credit guarantee measures relating to eligible United States agricultural commodities (other than upland cotton) are not within its terms of reference because this 'measure' was not the subject of Brazil's request for consultations".<sup>225</sup> Brazil responded that "both its request for consultations and the accompanying statement of available evidence, as well as the questions it posed to the United States during consultations, revealed that they covered export credit guarantee measures relating to *all* eligible United States agricultural commodities".<sup>226</sup>

<sup>219</sup>Panel Report, para. 7.108.

<sup>220</sup>*Ibid.*, paras. 7.112-7.115.

<sup>221</sup>*Ibid.*, para. 7.116-7.117.

<sup>222</sup>*Ibid.*, para. 7.121.

<sup>223</sup>*Ibid.*, paras. 7.109-7.110.

<sup>224</sup>We note that, during the interim review, Brazil requested the Panel "to conclude that GSM 102, GSM 103 and SCGP also constitute prohibited export subsidies within the meaning of item (j) and Article 3.1(a) of the *SCM Agreement*, for all products not covered by the *Agreement on Agriculture*". The Panel rejected Brazil's request, explaining that its "terms of reference include(d) export credit guarantees to facilitate the export of United States upland cotton and other eligible *agricultural* commodities as addressed in document WT/DS267/7". (Panel Report, para. 6.37. (original emphasis))

<sup>225</sup>Panel Report, para. 7.55. (footnote omitted)

<sup>226</sup>*Ibid.*, para. 7.57. (footnote omitted; emphasis added)

280. The Panel found that "the *actual* consultations did include export credit guarantee measures relating to all eligible agricultural commodities".<sup>227</sup> The Panel then examined the text of Brazil's request for consultations, "[a]ssuming *arguendo* that the scope of the written request for consultations is determinative, rather than the scope of the actual consultations".<sup>228</sup> It found "that export credit guarantee measures relating to all eligible agricultural commodities were included in Brazil's request for consultations, based on its reading of the text of the request itself".<sup>229</sup> Accordingly, the Panel made the following ruling in response to the United States' request:

[T]he Panel rules that export credit guarantees to facilitate the export of United States upland cotton, and other eligible agricultural commodities as addressed in document WT/DS267/7, are within its terms of reference.<sup>230</sup>

2. Arguments on Appeal

281. On appeal, the United States asserts that the Panel erred in finding that export credit guarantee measures relating to all eligible agricultural commodities were included in Brazil's request for consultations.<sup>231</sup> In addition, the United States takes issue with the Panel's finding that consultations were *actually* held on the export credit guarantee programs relating to agricultural commodities including, but not limited to, upland cotton.<sup>232</sup> The United States argues, in this regard, that the fact that Brazil posed written questions on the export credit guarantees relating to agricultural commodities including, but not limited to, upland cotton does not mean that consultations were *actually* held on all those products, especially considering that the United States objected to discussing them during the consultations on the basis that they were not included in the request for consultations.<sup>233</sup>

282. Brazil requests that we reject the United States' appeal. It contends that its request for consultations identified three United States export credit programs, namely, the General Sales Manager 102 ("GSM 102") and General Sales Manager 103 ("GSM 103") programs and the Supplier

<sup>227</sup>Panel Report, para. 7.61. (original italics; underlining added)

<sup>228</sup>*Ibid.*, para. 7.62.

<sup>229</sup>*Ibid.*, para. 7.65. The Panel explained that the title of this dispute, "United States – Subsidies on Upland Cotton", "did not appear in the original communication sent from the Permanent Mission of Brazil to the Permanent Mission of the United States", but rather "was added by the [WTO] Secretariat when it circulated a copy of the request for consultations to Members". Consequently, the Panel did not consider the title to be "a legally relevant consideration here". (*Ibid.*, footnote 131 to para. 7.64)

<sup>230</sup>Panel Report, para. 7.69. (footnote omitted)

<sup>231</sup>United States' appellant's submission, para. 474.

<sup>232</sup>*Ibid.*, para. 471.

<sup>233</sup>*Ibid.*, paras. 471-472.

Credit Guarantee Program (the "SCGP").<sup>234</sup> By their own terms, each of these measures applies to all eligible products.<sup>235</sup> Therefore, there was no need to specify the product scope of these measures.<sup>236</sup> Brazil submits that, in any event, its request for consultations in fact identified the export credit guarantee programs in connection with all eligible commodities, without any limitation to upland cotton.<sup>237</sup> Finally, Brazil asserts that, irrespective of the measures identified in Brazil's request for consultations, the Panel found, as a matter of fact, that "consultations were held" on the export credit guarantee programs in connection with all eligible commodities, as required by Article 6.2 of the DSU.<sup>238</sup>

3. Did the Panel's Terms of Reference Include Other Eligible Agricultural Commodities?

283. The United States claims on appeal that the Panel's terms of reference were limited to export credit guarantees to upland cotton, and did not include export credit guarantees to other eligible agricultural commodities. This claim is premised on the allegation that, in its request for the establishment of a panel, Brazil expanded the product scope in respect of which it challenges the United States' export credit guarantee programs to include other eligible agricultural products in addition to upland cotton. The United States submits that the request for consultations and the consultations themselves, however, were limited to export credit guarantees to upland cotton. Brazil contends that its request for consultations and the consultations held covered *all* agricultural products eligible for export credit guarantees.<sup>239</sup>

284. Before addressing the question of whether Brazil expanded, in its panel request, the scope of products in respect of which it challenged the United States' export credit guarantee programs, we note that the Appellate Body has explained previously that, "pursuant to Article 7 of the DSU, a

panel's terms of reference are governed by the request for establishment of a panel".<sup>240</sup> However, the Appellate Body has also explained that "as a general matter, consultations are a prerequisite to panel proceedings"<sup>241</sup> and has underscored the importance and benefits of consultations:

We agree ... on the importance of consultations. Through consultations, parties exchange information, assess the strengths and weaknesses of their respective cases, narrow the scope of the differences between them and, in many cases, reach a mutually agreed solution in accordance with the explicit preference expressed in Article 3.7 of the DSU. Moreover, even where no such agreed solution is reached, consultations provide the parties an opportunity to define and delimit the scope of the dispute between them. Clearly, consultations afford many benefits to complaining and responding parties, as well as to third parties and to the dispute settlement system as a whole.<sup>242</sup>

285. The requirements that apply to a request for consultations are set out in Article 4.4 of the DSU, which provides, in relevant part:

Any request for consultations shall be submitted in writing and shall give the reasons for the request, including identification of the measures at issue and an indication of the legal basis for the complaint.

The Appellate Body has stated that "Articles 4 and 6 of the DSU ... set forth a process by which a complaining party must request consultations, and consultations must be held, before a matter may be referred to the DSB for the establishment of a panel".<sup>243</sup> At the same time, however, the Appellate Body has said that it does not believe that "Articles 4 and 6 of the DSU ... require a *precise and exact identity* between the specific measures that were the subject of consultations and the specific

<sup>240</sup>Appellate Body Report, *US – Carbon Steel*, para. 124. Article 7.1 of the DSU provides: Panels shall have the following terms of reference unless the parties to the dispute agree otherwise within 20 days from the establishment of the panel:

To examine, in the light of the relevant provisions in (name of the covered agreement(s) cited by the parties to the dispute), the matter referred to the DSB by (name of party) in document ... and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in that/those agreement(s).

The United States does not dispute that Brazil's request for the establishment of a panel included export credit guarantees to eligible agricultural commodities including, but not limited to, upland cotton.

<sup>241</sup>Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 58.

<sup>242</sup>*Ibid.*, para. 54.

<sup>243</sup>Appellate Body Report, *Brazil – Aircraft*, para. 131.

<sup>234</sup>These programs are described *infra*, paras. 586-589.

<sup>235</sup>See Panel Report, footnote 1056 to para. 7.875.

<sup>236</sup>Brazil's appellee's submission, para. 195.

<sup>237</sup>*Ibid.*, para. 202.

<sup>238</sup>Brazil's appellee's submission, paras. 208-209. Brazil reads the Appellate Body Report in *Brazil – Aircraft* as meaning that as long as "consultations were held" on a measure included in a request for establishment of a panel, that measure is properly within a panel's terms of reference, irrespective of whether the measure was included in the request for consultations. (*Ibid.*, para. 213 (referring to Appellate Body Report, *Brazil – Aircraft*, paras. 132-134)) Brazil adds that this is consistent with the purpose of consultations. (*Ibid.*, para. 214)

<sup>239</sup>In addition, Brazil submits that the Panel's terms of reference are determined by the panel request, and that its panel request referred to all agricultural products eligible for the United States' export credit guarantees.

measures identified in the request for the establishment of a panel".<sup>244</sup> We need not elaborate further on the relationship between a panel's terms of reference and the requirement that "consultations were held", because, as we explain below, we are satisfied that, in this case, the Panel had a reasonable basis to conclude that the request for consultations included export credit guarantees to eligible agricultural commodities including, but not limited to, upland cotton.

286. In reviewing the Panel's analysis, we are faced with the question whether the scope of the consultations is determined by the written request for consultations or by what actually happens in the consultations. The Panel looked first at what actually happened during the consultations. It observed that Brazil submitted in writing to the United States 21 questions regarding export credit guarantee programs, seeking information on, *inter alia*, the total volume and value of exports of United States agricultural goods guaranteed by these programs.<sup>245</sup> According to the Panel, "[t]his shows that the actual consultations did include export credit guarantee measures relating to all eligible agricultural commodities".<sup>246</sup> The Panel then examined the text of Brazil's request for consultations, "[a]ssuming *arguendo* that the scope of the written request for consultations is determinative, rather than the scope of the actual consultations".<sup>247</sup>

287. We believe that the Panel should have limited its analysis to the request for consultations because we are inclined to agree with the panel in *Korea – Alcoholic Beverages*, which stated that "[t]he only requirement under the DSU is that consultations were in fact held ... [w]hat takes place in those consultations is not the concern of a panel".<sup>248</sup> Examining what took place in the consultations would seem contrary to Article 4.6 of the DSU, which provides that "[c]onsultations shall be confidential, and without prejudice to the rights of any Member in any further proceedings." Moreover, it would seem at odds with the requirements in Article 4.4 of the DSU that the request for

<sup>244</sup> Appellate Body Report, *Brazil – Aircraft*, para. 132. (original emphasis) The Appellate Body found, in that case, that certain measures that came into effect after consultations were held were nevertheless within the Panel's terms of reference, emphasizing that the measures did not change the essence of the challenged export subsidies. In *US – Certain EC Products*, the Appellate Body found that one of the measures challenged by the European Communities was not properly before the Panel. The Appellate Body explained that, although the panel request referred to the measure, it was not possible for it to conclude "on this basis *alone*" that the measure was within the Panel's terms of reference. It noted that the European Communities' request for consultations did not refer to the measure and that the European Communities acknowledged that the measure was not the subject of the consultations. In its ruling, the Appellate Body also emphasized that the particular measure was "separate" and "legally distinct" from another measure challenged by the European Communities. (Appellate Body Report, *US – Certain EC Products*, paras. 69-75) (original emphasis)

<sup>245</sup> The United States acknowledged that Brazil posed questions during the consultations that went beyond upland cotton. (Panel Report, para. 7.61) According to the Panel, the United States declined to respond to these questions during the consultations. (Panel Report, 7.67)

<sup>246</sup> Panel Report, para. 7.61. (original emphasis)

<sup>247</sup> *Ibid.*, para. 7.62.

<sup>248</sup> Panel Report, *Korea – Alcoholic Beverages*, para. 10.19.

consultations be made in writing and that it be notified to the DSB. In addition, there is no public record of what actually transpires during consultations and parties will often disagree about what, precisely, was discussed. Ultimately, however, it is not necessary for us to inquire into this part of the Panel's analysis because the Panel also found "that export credit guarantee measures relating to all eligible agricultural commodities were included in Brazil's request for consultations, based on its reading of the text of the request itself".<sup>249</sup> We turn, therefore, to examine whether there is a sufficient basis for the Panel's conclusion in this regard.

288. Brazil's request for consultations states, in relevant part<sup>250</sup>:

The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton<sup>1</sup>, as well as legislation, regulations, statutory instruments and amendments thereto providing such subsidies (including export credits), grants, and any other assistance to the US producers, users and exporters of upland cotton ("US upland cotton industry"). The measures include the following:

...

- Export subsidies, exporter assistance, export credit guarantees, export and market access enhancement to facilitate the export of US upland cotton provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs ...

...

Regarding export credit guarantees, export and market access enhancement provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, Brazil is of the view that these programs, as applied and as such, violate Articles 3.3, 8, 9.1, and 10.1 of the Agreement on Agriculture and are prohibited export subsidies under Article 3.1(a) and item (j) of the Illustrative List of Export Subsidies included as Annex I to the SCM Agreement. Subsidies provided under these programs are also actionable subsidies for the purpose of Brazil's claims under Article 6.3 of the SCM Agreement.

<sup>1</sup> Except with respect to export credit guarantee programs as explained below.

289. According to the Panel, footnote 1 to Brazil's request for consultations "should have indicated to the careful reader that the subject of the request for consultations, with respect to export credit

<sup>249</sup> Panel Report, para. 7.65.

<sup>250</sup> Request for Consultations by Brazil, *supra*, footnote 26, pp. 1-2 and 4.

guarantee measures only, was different from those provided to US producers, users and/or exporters of upland cotton".<sup>251</sup> The Panel also observed that the second paragraph after the footnote dealing with export credit guarantee programs referred to the programs as applied and as such, and it did not refer specifically to upland cotton. The Panel therefore concluded that "export credit guarantee measures relating to all eligible agricultural commodities were included in Brazil's request for consultations, based on its reading of the text of the request itself."<sup>252</sup>

290. The United States contends that the Panel ignored the first paragraph after the footnote and drew the wrong conclusion from the second paragraph. According to the United States, "it is simply not the case that a 'plain reading' of the [second] paragraph 'includes all eligible agricultural commodities'." Rather, it "shows that the [second] paragraph mentions *no* commodities at all".<sup>253</sup> The United States also asserts that the Panel "overlooked the context that th[e] first paragraph provided for the second".<sup>254</sup> The first paragraph, the United States points out, refers to exports subsidies, exporter assistance, and export credit guarantees to facilitate the export of *upland cotton* under a series of listed measures. A comparison of the first and second paragraphs shows that "the second did not describe measures, but, rather, described the *legal basis* for Brazil's complaint".<sup>255</sup> The United States submits that the Panel should therefore have concluded that "the two paragraphs complemented one another" and, "[t]hat being the case, there is no reason to believe (and certainly the Panel gave none) that the product scope of the second paragraph was broader than the 'upland cotton' mentioned in the first paragraph".<sup>256</sup> Finally, the United States argues that, "[e]ven assuming that the omission of the words 'upland cotton' from the second paragraph had some significance", the Panel gave no explanation as to "why the omission of those words should extend the product scope to 'all eligible agricultural commodities' rather than some other product scope".<sup>257</sup>

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<sup>251</sup>Panel Report, para. 7.63.

<sup>252</sup>*Ibid.*, para. 7.65.

<sup>253</sup>United States' appellant's submission, para. 476 (quoting Panel Report, para. 7.64). (original emphasis)

<sup>254</sup>*Ibid.*, para. 477.

<sup>255</sup>*Ibid.*, (original emphasis)

<sup>256</sup>*Ibid.*, para. 477.

<sup>257</sup>*Ibid.*, para. 479.

291. We have examined carefully Brazil's request for consultations and we find that it provides a sufficient basis for the Panel to have concluded that the request included export credit guarantees to eligible agricultural commodities including, but not limited to, upland cotton. Footnote 1 of the request for consultations, which states "Except with respect to export credit guarantee programs as provided below", alerts the reader that there is something different about Brazil's claims relating to the United States' export credit guarantee programs. Furthermore, the fact that the footnote follows immediately after the term "upland cotton" suggests that this difference relates to the product scope. It was not unreasonable, therefore, for the Panel to conclude that footnote 1 "should have indicated to the careful reader that the subject of consultations, with respect to export credit guarantee measures only, was different from those provided to US producer, users and/or exporters of upland cotton".<sup>258</sup> In addition, in the second paragraph dealing with export credit guarantees after the footnote, Brazil refers to the programs "as such", which suggests a broad challenge, rather than one limited to a specific agricultural commodity. In our view, therefore, the footnote, together with the reference to the programs "as such" in the second paragraph, provide a reasonable basis for the Panel's conclusion "that export credit guarantee measures relating to all eligible agricultural commodities were included in Brazil's request for consultations, based on its reading of the text of the request itself."<sup>259</sup>

292. The United States also cites the lack of any reference to agricultural commodities other than upland cotton in the statement of available evidence that is annexed to Brazil's request for consultations as "further proof that the request did not extend beyond export credit guarantees for upland cotton".<sup>260</sup> The United States raised this point as a separate claim on appeal and, therefore, we deal with this allegation in the next section of this Report. Below we uphold the Panel's finding that Brazil provided a statement of available evidence with respect to the United States' export credit guarantee programs as they relate to eligible agricultural products including, but not limited to, upland cotton.<sup>261</sup> and, consequently, this argument does not support the United States' position on this issue.

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<sup>258</sup>Panel Report, para. 7.63.

<sup>259</sup>*Ibid.*, para. 7.65. The facts of this case differ from those in *US – Certain EC Products*, on which the United States relies. In that case, the measure was not mentioned in the request for consultations because it was not even in existence at the time. (Appellate Body Report, *US – Certain EC Products*, para. 70)

<sup>260</sup>United States' appellant's submission, para. 461.

<sup>261</sup>See *infra*, para. 309.

293. We emphasize that consultations are but the first step in the WTO dispute settlement process. They are intended to "provide the parties an opportunity to define and delimit the scope of the dispute between them".<sup>262</sup> We also note that Article 4.2 of the DSU calls on a WTO Member that receives a request for consultations to "accord sympathetic consideration to and afford adequate opportunity for consultation regarding any representations made by another Member". As long as the complaining party does not expand the scope of the dispute, we hesitate to impose too rigid a standard for the "precise and exact identity"<sup>263</sup> between the scope of consultations and the request for the establishment of a panel, as this would substitute the request for consultations for the panel request. According to Article 7 of the DSU, it is the request for the establishment of a panel that governs its terms of reference, unless the parties agree otherwise.<sup>264</sup>

294. For these reasons, we uphold the Panel's ruling, in paragraph 7.69 of the Panel Report, that "export credit guarantees to facilitate the export of United States upland cotton, and other eligible agricultural commodities ... are within its terms of reference".

### C. *Statement of Available Evidence – Export Credit Guarantees*

#### I. Introduction

295. We now examine the United States' claim that the Panel erred in finding that Brazil's statement of available evidence was not limited to the United States' export credit guarantees to upland cotton, but also included export credit guarantee measures relating to other eligible United States agricultural products, as required by Article 4.2 of the *SCM Agreement*.

296. The United States requested the Panel to rule that Brazil "could not advance claims under ... Article 4 ... of the *SCM Agreement* with respect to export credit guarantee measures on eligible agricultural commodities other than upland cotton because it did not include a statement of available

evidence with respect to such export credit guarantees in accordance with Article[e] 4.2 ... of that Agreement".<sup>265</sup>

297. In examining the United States' request, the Panel noted that Brazil's statement of available evidence contained two paragraphs specifically referring to the United States' export credit guarantee programs<sup>266</sup>, and observed that the first paragraph is "textually limited to upland cotton", while the second paragraph "is not so limited".<sup>267</sup> The Panel then rejected the United States' contention that the lack of a reference to upland cotton in the second paragraph could not expand the scope of the statement of available evidence.<sup>268</sup> According to the Panel, when the second "paragraph is read in light of footnote 1 of the request for consultations, a careful reader should have been alerted to the fact that this paragraph referred to alleged subsidies arising from export credit guarantees under the challenged programmes, without any limitation to upland cotton or any other particular product or products".<sup>269</sup> Furthermore, the Panel stated that Brazil's statement of evidence referred to a website of the United States Congressional Budget Office, which includes data pertaining to the spending and

<sup>265</sup>Panel Report, para. 7.70. The Panel explained that the United States initially argued that Brazil's statement of available evidence as regards export credit guarantees was limited to upland cotton and did not extend to other eligible agricultural commodities, demonstrating that Brazil's request for consultations was limited to export credit guarantees relating to upland cotton. The request for a specific ruling on the adequacy of the statement of available evidence was made by the United States in its submission of 30 September 2003. (Panel Report, para. 7.71)

In addition, the Panel noted that the United States had made allegations under both Articles 4.2 and 7.2 of the *SCM Agreement*. The Panel observed that Article 4.2 relates to prohibited subsidies and Article 7.2 relates to claims against actionable subsidies. Then, the Panel stated that it was not necessary for it to rule on the United States' claim relating to Article 7.2 because: (i) Brazil challenged only one United States export credit guarantee program—GSM 102—as an actionable subsidy that caused serious prejudice; (ii) this allegation was limited to upland cotton; and (iii) the Panel had exercised judicial economy with respect to the claim. Thus, the Panel limited its examination to "whether Brazil included a statement of available evidence with respect to export credit guarantees on other eligible agricultural products in accordance with the requirement pertaining to its *export* subsidy allegations in Article 4.2 of the *SCM Agreement*". (Panel Report, paras. 7.73-7.74, 7.76, and 7.78-7.79) (original emphasis)

In its Notice of Appeal, the United States asserted that, in the event that Brazil appealed the Panel's exercise of judicial economy with respect to Brazil's claims concerning the compatibility of the United States' export credit guarantee measures with Part III of the *SCM Agreement*, the United States would conditionally request the Appellate Body to find that Brazil also failed to provide a statement of available evidence as required by Article 7.2 of the *SCM Agreement* and, accordingly, Brazil's claims concerning these measures were not within the Panel's terms of reference. (Notice of Appeal, *supra*, footnote 17, para. 13) The United States did not pursue this claim further in its appellant's submission. In any event, the condition on which the United States' appeal was based was not met, as Brazil did not appeal the Panel's exercise of judicial economy concerning the compatibility of the United States' export credit guarantee measures with Part III of the *SCM Agreement*.

<sup>266</sup>Panel Report, para. 7.83.

<sup>267</sup>*Ibid.*, para. 7.84.

<sup>268</sup>*Ibid.*, para. 7.84.

<sup>269</sup>*Ibid.*, para. 7.85. (footnoted omitted) Footnote 1 of Brazil's request for consultations reads: "Except with respect to export credit guarantee programs as explained below". See *supra*, para. 288.

<sup>262</sup>Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 54.

<sup>263</sup>Appellate Body Report, *Brazil – Aircraft*, para. 132. (emphasis omitted)

<sup>264</sup>Appellate Body Report, *US – Carbon Steel*, para. 124.

offsetting receipts of the Commodity Credit Corporation (the "CCC"). Neither the reference to the website nor the data on the website "contain any indication of limitation of Brazil's allegations concerning the export credit guarantee programmes to any specific product, such as, for example, upland cotton".<sup>270</sup>

298. Therefore, the Panel found:

[A]ssuming *arguendo* that the United States' request was timely<sup>[271]</sup>, the Panel rules that Brazil provided a statement of available evidence with respect to export credit guarantee measures relating to upland cotton and eligible United States agricultural products other than upland cotton, as required by Article 4.2 of the *SCM Agreement*.<sup>272</sup>

299. On appeal, the United States argues that the Panel's ruling is erroneous. The United States submits that Brazil's statement of evidence contains two paragraphs specifically referring to the United States' export credit guarantee programs.<sup>273</sup> The first paragraph is textually limited to upland cotton, as the Panel correctly found. Although the second paragraph does not refer to upland cotton, it contains no suggestion that it expands on the programs described in the preceding paragraph.<sup>274</sup> The United States further submits that, even if the second paragraph were construed to refer to programs that provide benefits to products other than upland cotton, it is "difficult to see" how that paragraph meets the requirements of Article 4.2 of the *SCM Agreement*, as it does not provide information about the "existence" or "nature" of the subsidies allegedly provided by the export credit guarantee programs to products in addition to upland cotton.<sup>275</sup>

300. Brazil submits that its statement of available evidence not only identifies the measures at issue—the United States' export credit guarantee programs—but also indicates the characteristics of those measures that had led Brazil to suspect that they constituted export subsidies, as required by the Appellate Body in *US – FSC*.<sup>276</sup> Specifically, Brazil's statement describes the failure of the export credit guarantee programs to establish premium rates that cover long-term operating costs and losses,

<sup>270</sup>Panel Report, paras. 7.92-7.93.

<sup>271</sup>Brazil had argued that the United States' request was untimely. The Panel found it unnecessary to rule on the timeliness of the United States' request, in the light of its ruling on the substantive question. (Panel Report, footnote 160 to para. 7.103)

<sup>272</sup>Panel Report, para. 7.103. (footnotes omitted)

<sup>273</sup>United States' appellant's submission, para. 494.

<sup>274</sup>*Ibid.*, paras. 495-496.

<sup>275</sup>United States' appellant's submission, para. 497.

<sup>276</sup>Brazil's appellee's submission, paras. 228-229 (referring to Appellate Body Report, *US – FSC*, para. 161).

which are central elements in a determination of whether a program constitutes an export subsidy under item (j) of the Illustrative List of Export Subsidies included as Annex I to the *SCM Agreement*.<sup>277</sup> Furthermore, the Panel made a factual finding that the documentary evidence cited by Brazil to support its preliminary view included a link to a United States government website with data showing that revenues for the export credit guarantee programs do not cover long-term operating costs and losses, which addressed the programs overall, rather than in connection with only upland cotton.<sup>278</sup> Thus, according to Brazil, its statement of available evidence met the requirements of Article 4.2, by identifying the export credit guarantee measures, and providing and describing available evidence of "the character of" those measures, across all eligible commodities, as export subsidies.<sup>279</sup>

2. Did Brazil's Statement of Available Evidence Include Export Credit Guarantees to Other Eligible Agricultural Commodities?

301. The issue raised on appeal is whether the Panel correctly concluded that Brazil's statement of available evidence was not limited to export credit guarantees to upland cotton and included export credit guarantees to other eligible agricultural commodities.<sup>280</sup> The requirement that a party challenging a prohibited subsidy provide a statement of available evidence is set out in Article 4.2 of the *SCM Agreement*, which provides:

A request for consultations under paragraph 1 shall include a statement of available evidence with regard to the existence and nature of the subsidy in question.

Article 4.2 is included in Appendix 2 of the DSU as a special or additional rule on dispute settlement.

302. The Appellate Body has stated that Article 4.2 of the *SCM Agreement* must be read and applied together with Article 4.4 of the DSU, which sets out the requirements for the request for consultations, "so that a request for consultations relating to a prohibited subsidy claim under the *SCM Agreement* must satisfy the requirements of both provisions".<sup>281</sup> It has also explained that the

<sup>277</sup>Brazil's appellee's submission, para. 230.

<sup>278</sup>*Ibid.*, paras. 231-232 (referring to Panel Report, paras. 7.92-7.93).

<sup>279</sup>*Ibid.*, para. 233.

<sup>280</sup>The United States does not contest that Brazil submitted a statement of available evidence together with its request for consultations. Nor does the United States contest that Brazil's statement of available evidence referred to the United States' export credit guarantees as they relate to upland cotton.

<sup>281</sup>Appellate Body Report, *US – FSC*, para. 159.

"additional requirement of 'a statement of available evidence' under Article 4.2 of the *SCM Agreement* is distinct from—and not satisfied by compliance with—the requirements of Article 4.4 of the DSU".<sup>282</sup>

303. Brazil's statement of available evidence is annexed to its request for consultations. As the Panel noted<sup>283</sup>, the statement contains the following two paragraphs referring specifically to the United States' export credit guarantee programs:

US export credit guarantee programs have caused serious prejudice to Brazilian upland cotton producers by providing below-market financing benefits for the export of competing US upland cotton;

US export credit guarantee programs, since their origin in 1980 and up [to] the present, provide premium rates that are inadequate to cover the long-term operating costs and losses of the programs; in particular there were losses caused by large-scale defaults totalling billions of dollars that have not been reflected in increased premiums to cover such losses[.]<sup>284</sup>

304. The United States asserts that Brazil's statement of evidence does not mention any agricultural commodity other than upland cotton when it refers to the United States' export credit guarantee programs. This is correct. At the same time, however, we observe that the second paragraph is not expressly limited to upland cotton. Rather, that paragraph refers to the United States' export credit guarantee programs in a general way, suggesting that the reference is to the programs as a whole and not just as they relate to one specific agricultural commodity. The allegation in that paragraph that the premium rates are inadequate to cover the long-term operating costs and losses of the programs is equally broad and does not suggest that it is only with respect to upland cotton that premiums are insufficient to offset costs and losses. As the Panel explained, when the second "paragraph is read in light of footnote 1 of the request for consultations, a careful reader should have been alerted to the fact that this paragraph referred to alleged subsidies arising from export credit guarantees under the challenged programmes, without any limitation to upland cotton or any other particular product or products".<sup>285</sup> Thus, we do not find that it was unreasonable for the Panel to have "read Brazil's statement of available evidence, insofar as Brazil's export subsidy claims are concerned, to refer to

<sup>282</sup> Appellate Body Report, *US – FSC*, para. 161.

<sup>283</sup> Panel Report, para. 7.83.

<sup>284</sup> Statement of available evidence annexed to the Request for Consultations by Brazil, *supra*, footnote 26, para. 3.

<sup>285</sup> Panel Report, para. 7.85. (footnote omitted) The text of footnote 1 is reproduced, *supra*, footnote 269.

each of the three challenged United States export subsidy programmes as they relate to upland cotton and other eligible agricultural products".<sup>286</sup>

305. The United States submits that, even if the second paragraph were construed to refer to programs that provide benefits to products in addition to upland cotton, it is "difficult to see"<sup>287</sup> how that paragraph meets the requirements of Article 4.2 of the *SCM Agreement*, as it does not provide information about the "existence" or "nature" of the subsidies allegedly provided by the export credit guarantee programs to products in addition to upland cotton. The Panel rejected the United States' argument because it considered that:

Brazil's statement of available evidence indicates Brazil's view that the character of the alleged subsidy lay in the provision of export credit guarantees under programmes "at premium rates that are inadequate to cover the long-term operating costs and losses of the programs; in particular there were losses caused by large-scale defaults totalling billions of dollars that have not been reflected in increased premiums to cover such losses".<sup>288</sup>

From this, the Panel concluded that Brazil "had evidence available to it at that time which led it to conclude that the United States was providing a prohibited export subsidy of this nature and character under the three identified export subsidy programmes, without any limitation to a particular product or products".<sup>289</sup>

306. We recall that Article 4.2 requires that the request for consultations "include a statement of available evidence with regard to the existence and nature of the subsidy in question". In *US – FSC*, the Appellate Body explained that this means that "it is available evidence of the character of the measure as a 'subsidy' that must be indicated, and not merely evidence of the existence of the measure".<sup>290</sup> We observe that, in Brazil's statement of available evidence, the second paragraph that deals specifically with the United States' export credit guarantee programs does not simply refer to their existence. In that paragraph, Brazil indicates that the export credit guarantees have the

<sup>286</sup> Panel Report, para. 7.86.

<sup>287</sup> United States' appellant's submission, para. 497.

<sup>288</sup> Panel Report, para. 7.89 (quoting statement of available evidence, *supra*, footnote 284, para. 3).

<sup>289</sup> *Ibid.*, para. 7.90.

<sup>290</sup> Appellate Body Report, *US – FSC*, para. 161. In that case, the European Communities did not provide a separate statement of available evidence, but argued that such a statement was contained in the request for consultations itself. The Panel found that the consultations request may have contained a statement of available evidence. The Appellate Body noted that it "would have preferred that the Panel give less relaxed treatment to this important distinction" between the existence and the character of the measure as a subsidy, but it ultimately ruled that the United States' objection to the request for consultations had been untimely and therefore it did not rule on whether the consultations request included a statement of available evidence. (*Ibid.*, paras. 155, 161, and 165)

"character" of a subsidy because the premiums charged are insufficient to cover the long-term operating costs and losses. Brazil goes further by stating that this situation is especially due to the fact that the premiums have not increased despite "large-scale defaults totalling billions of dollars".<sup>291</sup>

307. In addition, as the Panel pointed out, Brazil referred to a website of the United States Congressional Budget Office. This website includes projections of the mandatory spending of the United States federal government. One of the tables provided on the website contains a line-item that specifically refers to spending by the CCC, which, according to the title of the table, already takes into account offsetting receipts. Thus, by referring to this website, Brazil's statement of evidence was also indicating that the export credit guarantees have the "character" of a subsidy because the premiums charged are insufficient to cover the long-term operating costs and losses. Therefore, the Panel had a reasonable basis to conclude that Brazil's statement of evidence met the requirements of Article 4.2 of the *SCM Agreement*.

308. We recognize that the statement of available evidence plays an important role in WTO dispute settlement. The adequacy of the statement of available evidence must be determined on a case by case basis. As the Panel stated, moreover, the "statement of available evidence ... is the starting point for consultations, and for the emergence of more evidence concerning the measures by reason of the clarification of the 'situation'".<sup>292</sup> It is, therefore, important to bear in mind that the requirement to submit a statement of available evidence applies in the earliest stages of WTO dispute settlement, and that the requirement is to provide a "statement" of the evidence and not the evidence itself.<sup>293</sup>

309. For these reasons, we *uphold* the Panel's ruling, in paragraph 7.103 of the Panel Report, that "Brazil provided a statement of available evidence with respect to export credit guarantee measures relating to upland cotton and eligible United States agricultural products other than upland cotton, as required by Article 4.2 of the *SCM Agreement*". (footnote omitted)

<sup>291</sup>Statement of available evidence annexed to the Request for Consultations by Brazil, *supra*, footnote 26, para. 3.

<sup>292</sup>Panel Report, para. 7.100.

<sup>293</sup>Panel Report, *Australia – Automotive Leather II*, para. 9.19.

## V. Domestic Support

### A. Article 13(a) of the Agreement on Agriculture – Planting Flexibility Limitations

#### 1. Introduction

310. We turn now to consider appeals by the United States and Brazil regarding the application of Article 13 of the *Agreement on Agriculture* (often referred to as the "peace clause"). We first address the issue of whether two types of payment—production flexibility contract payments and direct payments—are entitled to the exemption from action established by paragraph (a) of Article 13.

311. Production flexibility contract payments were introduced by the FAIR Act of 1996 for the 1996-2002 marketing years, and were made to certain historical producers of seven eligible commodities, including upland cotton. Historical producers could enroll acres upon which upland cotton had been grown during a base period and were allocated upland cotton "base acres" (as well as a farm-specific yield per acre), for which payment would be made at a rate specified each year for upland cotton. The production flexibility contract program dispensed with the requirement that producers continue to plant upland cotton in order to receive payments; instead, payments would generally be made regardless of what the producer chose to grow, and whether or not the producer chose to produce anything at all. However, there were limits to this planting flexibility. Specifically, payments were reduced or eliminated if fruits and vegetables (other than lentils, mung beans, and dry peas) were planted on upland cotton base acres, subject to certain other exceptions.<sup>294</sup>

312. Direct payments were introduced by the FSRI Act of 2002 for the 2002-2007 marketing years. They essentially replaced production flexibility contract payments under the FAIR Act of 1996, while also expanding the program to take in historical production of some additional commodities.<sup>295</sup> Both production flexibility contract payments and direct payments were available for the 2002 crop, but production flexibility contract payments made for that crop were deducted from direct payments made for that crop.<sup>296</sup> Like production flexibility contract payments for upland cotton, direct payments for upland cotton were dependent on base acres allocated by reference to the

<sup>294</sup>Panel Report, paras. 7.212-7.215 and 7.376-7.378. The exceptions from planting flexibility limitations related to regions with a history of double cropping or farms with a history of planting fruits or vegetables on contract acreage. (*Ibid.*, para. 7.378)

<sup>295</sup>*Ibid.*, paras. 7.218-7.219 and 7.397. The Panel discusses similarities and differences between the production flexibility contract program and the direct payment program in paragraphs 7.398-7.399.

<sup>296</sup>*Ibid.*, para. 7.220.

production of upland cotton during certain base periods.<sup>297</sup> The payments were made each year at a rate fixed for the entire 2002-2007 period at 6.67 cents per pound of upland cotton. As was the case under the production flexibility contract program, producers were not required to grow any particular crop in order to receive direct payments, and could choose to grow nothing at all. In addition to fruits and vegetables (other than lentils, mung beans, and dry peas), wild rice was added to the planting flexibility limitations.<sup>298</sup>

313. The Panel found that the amount of payments under the production flexibility contract program and the direct payment program is "related to the type of production undertaken by the producer after the base period."<sup>299</sup> On this basis, the Panel found that these payments and "the legislative and regulatory provisions that provide for the planting flexibility limitations in the DP programme" do not fully conform to paragraph 6(b) of Annex 2 of the *Agreement on Agriculture*.<sup>300</sup> The Panel concluded that these measures are thus not green box measures<sup>301</sup>, and added that these measures "do not comply with the condition in paragraph (a) of Article 13 of the *Agreement on Agriculture*" and are therefore "non-green box measures covered by paragraph (b) of Article 13."<sup>302</sup>

## 2. Appeal by the United States

314. The United States appeals the Panel's finding that direct payments, production flexibility contract payments, and the legislative and regulatory provisions that establish and maintain the direct payments program, are not green box measures sheltered from challenge by virtue of Article 13(a) of the *Agreement on Agriculture*. The United States does not dispute that the amount of payments under the production flexibility contract and direct payment programs depended upon a formula that centred on "base acres" tied to the historical production of upland cotton.<sup>303</sup> Nor does the United States dispute that there are limitations on producers' ability to plant any product, if those producers wish to

<sup>297</sup>There was a limited opportunity for producers to elect a different base period for the calculation of upland cotton base acres for direct payments under the FSRI Act of 2002 from that prevailing for production flexibility contract payments under the FAIR Act of 1996. (Panel Report, paras. 7.220-7.221) Brazil has conditionally appealed the Panel's exercise of judicial economy in respect of Brazil's claim that this "updating" of base acres contravenes paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*. We address this conditional appeal below at section V.B of this Report.

<sup>298</sup>Panel Report, paras. 7.220, 7.222, and 7.379-7.381. As was the case under the production flexibility contract program, there were limited exceptions to the planting flexibility limitations.

<sup>299</sup>*Ibid.*, para. 7.385.

<sup>300</sup>*Ibid.*, para. 7.388.

<sup>301</sup>*Ibid.*, para. 7.413.

<sup>302</sup>*Ibid.*, para. 7.414.

<sup>303</sup>United States' appellant's submission, para. 17.

receive production flexibility or direct payments with respect to upland cotton base acres.<sup>304</sup> In the case of production flexibility contract payments, these limitations related to the growing of fruits and vegetables. In the case of direct payments, the limitations extended to wild rice as well.<sup>305</sup> Beyond these limitations, however, the United States stresses that a producer can receive production flexibility contract payments or direct payments regardless of the agricultural products that the producer chooses to grow and irrespective of whether it chooses to produce any product at all.<sup>306</sup>

315. The United States takes issue with the Panel's finding that the planting flexibility limitations mean that the "amount of payments" under the production flexibility contract and direct payment programs is "related to the type of production undertaken by the producer after the base period", within the meaning of paragraph 6(b) of Annex 2 to the *Agreement on Agriculture*.<sup>307</sup> According to the United States, a *negative* direction in respect of production of certain goods—that is, conditioning payment on a producer's *non*-production of certain goods—does not make the amount of payments "related to the type of production". The United States submits that this interpretation serves the "fundamental requirement" found in paragraph 1 of Annex 2 that green box measures "have no, or at most minimal, trade-distorting effects or effects on production".

316. Brazil requests that the Appellate Body uphold the Panel's finding, under paragraph 6(b) of Annex 2 of the *Agreement on Agriculture*, that production flexibility contract and direct payments relate "the amount of" the payment to "the type of production undertaken" by recipients.<sup>308</sup> The grounds for the Panel's finding are that production flexibility contract and direct payments are made solely if production is undertaken of crops other than fruits and vegetables (and, in the case of direct payments, wild rice as well). Brazil agrees with the Panel that this relates the amount of payments to production of the "permitted" crops. As the Panel found, if "permitted" crops alone are produced, a full payment is made. If a small quantity of "prohibited" crops is produced, the "amount of payment" is reduced. If a larger quantity of "prohibited" crops is produced, no payment is made.<sup>309</sup>

317. Brazil submits that the distinction drawn by the United States between "permitted" (or positive) and "prohibited" (or negative) categories of crops is artificial because the effect of both

<sup>304</sup>See, for example, United States' appellant's submission, paras. 17 ff.

<sup>305</sup>United States' appellant's submission, para. 18.

<sup>306</sup>*Ibid.*

<sup>307</sup>Panel Report, para. 7.385; United States' appellant's submission, paras. 22 ff.

<sup>308</sup>Panel Report, para. 7.385; Brazil's appellee's submission, paras. 260 ff.

<sup>309</sup>Brazil's appellee's submission, para. 285 (referring to Panel Report, paras. 7.382-7.383). The participants, like the Panel, refer to "permitted" and "prohibited" crops, in the sense that crops not subject to planting flexibility limitations are eligible to receive payments, while fruits and vegetables (and wild rice) are not eligible to receive payments. We generally prefer to refer to these categories as "covered" or "eligible" crops, on the one hand, and "excluded" crops on the other.

categories is identical: in both cases, production is channelled *away from* certain "prohibited" crops (for which no payments are made) and *towards* other "permitted" crops (for which payments are made). Thus, the incentives and disincentives are precisely the same. In both cases, "the amount of" the payment is intrinsically "related to" undertaking production of the "permitted" crops, and not undertaking production of the "prohibited" crops. According to Brazil, the Panel's factual findings support this view because it found that the prohibition on fruits and vegetables (and wild rice in respect of direct payments) imposes "significant constraints" on production decisions and creates incentives for the production of eligible crops rather than those crops that are prohibited.<sup>310</sup>

### 3. Analysis

318. Article 13 of the *Agreement on Agriculture*, entitled "Due Restraint", provides in relevant part that:

During the implementation period, notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and Countervailing Measures (referred to in this Article as the "Subsidies Agreement"):

- (a) domestic support measures that conform fully to the provisions of Annex 2 to this Agreement shall be: ...
- (ii) exempt from actions based on Article XVI of GATT 1994 and Part III of the Subsidies Agreement; ...

319. Accordingly, domestic support that conforms fully to the provisions of Annex 2—that is "green box" support, which is exempt from the domestic support reduction obligations of the *Agreement on Agriculture*—is also exempt, during the implementation period<sup>311</sup>, from actions based on Article XVI of GATT 1994 and the actionable subsidies provisions of Part III of the *SCM Agreement*.

320. The United States claims that production flexibility contract payments and direct payments are domestic support that conforms fully to the provisions of Annex 2 because they are "[d]ecoupled income support" within the meaning of paragraph 6 of that Annex. Annex 2 is entitled "Domestic

<sup>310</sup>Brazil's appellee's submission, paras. 285-286 (quoting Panel Report, para. 7.386).

<sup>311</sup>The "implementation period" during which Article 13 applies is defined in Article 1(f) of the *Agreement on Agriculture* as "the nine-year period commencing in 1995". "Year", for purposes of Article 1(f) "and in relation to the specific commitments of a Member" is defined in Article 1(c) and is "the calendar, financial or marketing year specified in the Schedule relating to that Member".

Support: The Basis for Exemption from the Reduction Commitments" and provides, in relevant part, as follows:

1. Domestic support measures for which exemption from the reduction commitments is claimed shall meet the *fundamental requirement* that they have *no, or at most minimal, trade-distorting effects or effects on production*. Accordingly, all measures for which exemption is claimed shall conform to the following basic criteria:

- (a) the support in question shall be provided through a publicly-funded government programme (including government revenue foregone) not involving transfers from consumers; and,
- (b) the support in question shall not have the effect of providing price support to producers;

plus policy-specific criteria and conditions as set out below.

### 5. *Direct payments to producers*

Support provided through direct payments (or revenue foregone, including payments in kind) to producers for which exemption from reduction commitments is claimed shall meet the basic criteria set out in paragraph 1 above, plus specific criteria applying to individual types of direct payment as set out in paragraphs 6 through 13 below. ...

### 6. *Decoupled income support*

- (a) Eligibility for such payments shall be determined by *clearly-defined criteria* such as income, status as a producer or landowner, factor use or production level in a *defined and fixed base period*.
- (b) *The amount of such payments in any given year shall not be related to, or based on, the type or volume of production* (including livestock units) undertaken by the producer in any year *after* the base period.
- (c) *No production shall be required* in order to receive such payments. (emphasis added)

321. Paragraph 6, entitled, "[d]ecoupled income support" applies to one type of "direct payment" to producers that may benefit from exemption from reduction commitments and protection under the peace clause. Paragraph 6(a) sets forth that eligibility for payments under a decoupled income support program must be determined by reference to certain "clearly-defined criteria" in a "defined

and fixed base period". Paragraph 6(b) requires the severing of any link between the *amount of payments* under such a program and the *type or volume of production* undertaken by recipients of payments under that program in any year after the base period. Paragraphs 6(c) and 6(d) serve to require that payments are also decoupled from *prices* and *factors of production employed* after the base period. Paragraph 6(e) makes it clear that "[n]o production shall be required in order to receive ... payments" under a decoupled income support program.

322. As we noted above<sup>312</sup>, there is no disagreement between the participants that the amount of payments under the production flexibility contract and direct payment programs depended upon a formula that centred on "base acres", which were established on the basis of the historical production of upland cotton. Nor does the United States dispute that there are limitations on producers' ability to produce certain products, while also receiving production flexibility contract payments or direct payments with respect to upland cotton base acres. Therefore, the question before us regarding the consistency of production flexibility contract payments and direct payments with paragraph 6(b) of Annex 2 is a limited one. It does not concern a measure *requiring* producers to grow certain crops in order to receive payments; it also does not concern a measure with complete planting *flexibility* that provides payments without regard whatsoever to the crops that are grown. Indeed, it does not concern a measure that requires the production of any crop at all; nor does it involve a measure that totally *prohibits* the growing of any crops as a condition for payments. The question before us in this appeal thus concerns a measure with a *partial* exclusion combining planting flexibility and payments with the reduction or elimination of the payments when the excluded crops are produced, while providing payments even when no crops are produced at all.

323. In addressing the question of the consistency of such a measure with paragraph 6(b), we note that under this provision, for income support to be *decoupled*, the "amount of such payments ... shall not be related to ... the type or volume of production ... undertaken by the producer in any year after the base period". It is uncontested that the amount of payments under the production flexibility contract and direct payment programs may be affected, depending upon whether a producer plants a crop that is permitted under the production flexibility contract or direct payment programs, or a crop that is covered by the planting flexibility limitations.<sup>313</sup> The United States focuses on the term "related to" and contends that the amount of payments under the production flexibility contract and direct payment programs is not "related to" the type of production as proscribed by paragraph 6(b).

<sup>312</sup>*Supra*, para. 314.

<sup>313</sup>United States' appellant's submission, para. 18.

324. The ordinary meaning of the term "related to" in paragraph 6(b) of Annex 2 denotes some degree of *relationship* or *connection* between two things<sup>314</sup>, here the amount of payment, on the one hand, and the type or volume of production, on the other. It covers a broader set of connections than "based on", which term is also used to describe the relationship between two things covered by paragraph 6(b).<sup>315</sup> Nothing in the ordinary meaning of the term "related to" suggests that the connections covered by this expression may not encompass connections of either a "positive" nature (including directions or requirements to do something) or a "negative" nature (including prohibitions or requirements not to do something) or a combination of both. As the Panel indicated, the ordinary meaning of the term "related to" conveys "a very general notion".<sup>316</sup> Indeed, the United States agrees that, as far as its ordinary meaning in the abstract is concerned, the term "related to" may be broad enough to capture both positive and negative connections, but argues that the context of paragraph 6(b) requires a more limited interpretation of the term, namely, only as covering a "positive" connection between the "amount of ... payments" and the "type ... of production".<sup>317</sup> Like the Panel, however, we are of the view that, in the context of paragraph 6(b), the term "related to" covers both positive and negative connections between the amount of payment and the type of production.

325. Paragraph 6 of Annex 2, entitled "[d]ecoupled income support", seeks to decouple or de-link direct payments to producers from various aspects of their production decisions and thus aims at neutrality in this regard. Subparagraph (b) decouples the payments from production; subparagraph (c) decouples payments from prices; and subparagraph (d) decouples payments from factors of production. Subparagraph (e) completes the process by making it clear that no production shall be required in order to receive such payments. Decoupling of payments from production under paragraph 6(b) can only be ensured if the payments are not related to, or based upon, either a positive

<sup>314</sup>See *Shorter Oxford English Dictionary*, 5th ed., W.R. Trumble, A. Stevenson (eds.), (Oxford University Press, 2002), Vol. 2, p. 2520; see also Panel Report, para. 7.366; United States' appellant's submission, para. 25; and Brazil's appellee's submission, para. 282.

<sup>315</sup>The Panel noted that "base" in this context may be defined as to "found, build, or construct (*upon*) a given base, build up *around* a base (chiefly *fig.*)"; Panel Report, para. 7.366 (quoting *The New Shorter Oxford English Dictionary*, L. Brown (ed.) (Clarendon Press, 1993), Vol. 1, p. 187). Like the expression "related to", "based on" does not require a strict relationship between two things (see, e.g., Appellate Body Report, *EC – Hormones*, paras. 165-166 and 171), the meaning of "based on" indicates a relatively close connection between the things being linked. By contrast, the meaning of "related to" can apply to connections more general in nature than situations in which one thing is "based on" another (see, e.g., Appellate Body Report, *US – Softwood Lumber IV*, para. 89, where the Appellate Body interpreted broadly the phrase "in relation to" in Article 14(d) of the *SCM Agreement*). Accordingly, the meaning of the term "related to" cannot be entirely subsumed into the meaning of "based on".

<sup>316</sup>Panel Report, para. 7.366.

<sup>317</sup>United States' appellant's submission, para. 25.

requirement to produce certain crops or a negative requirement not to produce certain crops or a combination of both positive and negative requirements on production of crops.

326. In contrast to the other subparagraphs of paragraph 6, paragraph 6(e) does explicitly distinguish between positive and negative production requirements, because it prohibits positive requirements to produce. The Panel reasoned that "[i]f paragraph 6(b) could be satisfied by ensuring that no production was required to receive payments, paragraph 6(e) would be redundant".<sup>318</sup> We agree with the Panel that the context provided by paragraph 6(e) indicates that a measure that provided payments, even if a producer undertook no production at all, would not, for that reason alone, necessarily comply with paragraph 6(b). This is because other elements of that measure might still relate the amount of payments to the type or volume of production, contrary to the requirement of paragraph 6(b).

327. The United States seems to argue that the Panel's interpretation of the relationship between paragraphs 6(b) and 6(e) would subsume paragraph 6(e) within the scope of paragraph 6(b), thereby rendering it redundant.<sup>319</sup> In our view, however, paragraph 6(e) continues to serve a purpose distinct from that of paragraph 6(b). It highlights a different aspect of decoupling income support. In prohibiting Members from making green-box measures contingent on production, paragraph 6(e) implies that Members are allowed, in principle, to require no production at all. Accordingly, payments conditioned on a total ban on any production may qualify as decoupled income support under paragraph 6(e). Even assuming that payments contingent on a total production ban could be seen to relate the amount of the payment to the *volume* of production within the meaning of paragraph 6(b)—the volume of production being nil—giving meaning and effect to both paragraphs 6(b) and 6(e) suggests a reading of paragraph 6(b) that would not disallow a total ban on any production.

328. In addressing the United States' argument on this point, we recall that the measures at issue in this appeal do not provide for payments contingent on a *total ban* on production of *any* crops. The measures at issue here combine payments and planting flexibility in respect of certain covered crops with the reduction or elimination of such payments when certain other excluded crops are produced. The United States argues that, if paragraph 6(e) means that a Member may require a producer not to produce a particular product, "it would not make sense to then prohibit a Member, under paragraph 6(b), from making the amount of payment contingent on fulfilling that requirement".<sup>320</sup>

<sup>318</sup>Panel Report, para. 7.368.

<sup>319</sup>United States' appellant's submission, paras. 38-42.

<sup>320</sup>*Ibid.*, para. 38. (emphasis omitted)

However, in our view, the mere fact that under paragraph 6(e) "[n]o production shall be required in order to receive such payments" does not mean that a partial exclusion of certain crops from payments, coupled with production flexibility regarding other crops, must be consistent with paragraph 6(b).

329. We agree with the Panel that a partial exclusion of some crops from payments has the potential to channel production towards the production of crops that remain eligible for payments.<sup>321</sup> In contrast to a total production ban, the channelling of production that may follow from a partial exclusion of some crops from payments will have *positive* production effects as regards crops eligible for payments. The extent of this will depend on the scope of the exclusion. We note in this regard that the Panel found, as a matter of fact, that planting flexibility limitations at issue in this case "significantly constrain production choices available to PFC and DP payment recipients and effectively eliminate a significant proportion of them".<sup>322</sup> The fact that farmers may continue to receive payments if they produce nothing at all does not detract from this assessment because, according to the Panel, it is not the option preferred by the "overwhelming majority" of farmers, who continue to produce some type of permitted crop.<sup>323</sup> In the light of these findings by the Panel, we are unable to agree with the United States' argument that the planting flexibility limitations only negatively affect the production of crops that are excluded.

330. We are not persuaded otherwise by the United States' reliance upon the terms "amount of such payments" and "undertaken" in the text of paragraph 6(b). According to the United States, the Panel assumes that the "amount of such payments" in paragraph 6(b) can be related to the current type of production because, in some circumstances, a recipient that produces fruits, vegetables or wild rice "receives less payment than that recipient otherwise would have been entitled to".<sup>324</sup> However, for the United States, in that case, the only "amount" of payment that is even arguably "related to" current production is "zero"<sup>325</sup>, because those crops are excluded from payment eligibility. The United States further argues, with respect to the phrase "production ... undertaken by the producer", that the ordinary meaning of the term "undertake" includes to "attempt". In this case, the planting flexibility limitations on a certain range of products, with respect to base acreage, would not relate the amount of payments

<sup>321</sup>Panel Report, para. 7.367. Indeed, as Brazil submits, this will tend to be the case where the prohibition prevents a producer, intent on maximizing profit, from growing the best alternative crop. In that case, the producer will tend to choose the next best alternative from amongst the permitted crops. (Brazil's appellee's submission, para. 321, citing evidence, referred to in footnote 511 of the Panel Report, from Brazil's expert, Professor Sumner)

<sup>322</sup>Panel Report, para. 7.386.

<sup>323</sup>*Ibid.*, para. 7.386.

<sup>324</sup>United States' appellant's submission, para. 26.

<sup>325</sup>*Ibid.*

to production "attempted" by the recipient; rather, the amount of payment is related to or based on the type of production *not* "attempted".<sup>326</sup>

331. In our view, the concepts of "type or volume of production ... undertaken by the producer" and the "amount of ... payments" are linked in paragraph 6(b) by the requirement that one "not be related to" the other. This requires a consideration of *the relationship* between the type or volume of production and the amount of payment under a program after the base period. A program that disallows payments when certain crops are produced relates the amount of the payment to the type of production undertaken. The flexibility to produce and receive payment for certain crops covered by a program, combined with the reduction or elimination of such payments when excluded crops are produced, creates a link with the type of production undertaken contrary to paragraph 6(b). This is so because the opportunity for farmers to receive payments for producing covered crops, while less or no such payments are made to farmers who produce excluded crops, provides an incentive to switch from producing excluded crops to producing crops eligible for payments.

332. The United States also contends that its measures, which condition payment on the non-production of certain products, "further the fundamental requirement [in paragraph 1 of Annex 2 to the *Agreement on Agriculture*] that such measures 'have no, or at most minimal, trade-distorting effects or effects on production'"<sup>327</sup>, because their only effects are to reduce production of the prohibited crops.<sup>328</sup> It follows, for the United States, that paragraph 6(b) should not address "negative" prohibitions on the production of certain crops, such as the United States' measures, given that they comply, inherently, with the fundamental requirement.<sup>329</sup> Brazil argues that if paragraph 6(b) is violated, this *ipso facto* violates the fundamental requirement of paragraph 1 of Annex 2 and further analysis is not required.<sup>330</sup>

333. We note that the first sentence of paragraph 1 of Annex 2 lays down a "fundamental requirement" for green box measures, such that they must have "no, or at most minimal, trade-distorting effects or effects on production". The second sentence of paragraph 1 provides that, "[a]ccordingly", green box measures must conform to the basic criteria stated in that sentence, "plus"

<sup>326</sup>United States' appellant's submission, para. 27.

<sup>327</sup>Paragraph 1 of Annex 2 to the *Agreement on Agriculture*.

<sup>328</sup>United States' appellant's submission, para. 36.

<sup>329</sup>See *ibid.*, paras. 32-35.

<sup>330</sup>Brazil's responses to questioning at the oral hearing.

the policy-specific criteria and conditions set out in the remaining paragraphs of Annex 2, including those in paragraph 6.<sup>331</sup>

334. As we have noted, the Panel found that the planting flexibility limitations in this case "significantly constrain" production decisions.<sup>332</sup> However one reads the "fundamental requirement" in paragraph 1 of Annex 2, given the factual findings of the Panel, the facts of this case do not present a situation in which the planting flexibility limitations demonstrably have "no, or at most minimal," trade-distorting effects or effects on production.

335. We find further support for our interpretation of paragraph 6(b) in the context provided by paragraph 11 of Annex 2, entitled "Structural adjustment assistance provided through investment aids". Several of the subparagraphs of paragraph 11 are phrased in similar terms to those of paragraph 6. Indeed, like paragraph 6(b), paragraph 11(b) requires that the "amount of ... payments ... shall not be related to ... the type or volume of production ... undertaken by the producer in any year after the base period." However, unlike paragraph 6(b), paragraph 11(b) ends with the phrase "other than as provided for under criterion (c) below". Criterion 11(c) specifically envisages that "payments shall not mandate or in any way designate the agricultural products to be produced by the recipients except to require them not to produce a particular product".

336. We note that the exception provided by paragraph 11(c) and the link to paragraph 11(e) in paragraph 11(b) explicitly *authorize* the type of "negative" requirements not to produce that the United States argues is implicitly *permitted* by the terms of paragraph 6(b). In the light of the similarity of the language chosen in paragraphs 6(b) and 11(b), like the Panel, we attach significance to the fact that the drafters saw as necessary an explicit authorization of negative requirements not to produce under paragraph 11(b). In our view, this indicates that the ordinary meaning of the terms in paragraph 11(b) would otherwise exclude an interpretation allowing such negative requirements. The use of identical language in paragraphs 6(b) and 11(b), except for the reference in paragraph 11(b) to paragraph 11(c), suggests that the meaning of the terms in paragraph 6(b) must be the same as in paragraph 11(b). Accordingly, a comparison of these provisions confirms that the terms of paragraph 6(b) encompass both positive as well as negative connections between the amount of payments under a program and the type of production undertaken.

337. We note that the United States argues that the context in which paragraphs 11(b) and 6(b) appear is very different. The United States notes that paragraph 11 pertains to payments "to assist the

<sup>331</sup>We note in this regard that the Panel's exercise of judicial economy regarding Brazil's claim that the United States measures at issue fail to conform with the "fundamental requirement" of paragraph 1 of Annex 2 has not been appealed. (See Panel Report, para. 7.412)

<sup>332</sup>*Ibid.*, para. 7.386.

financial or physical restructuring of a producer's operations<sup>333</sup> and paragraph 6(e) imposes a constraint on the degree to which a government can interfere in the form that restructuring will take. As a requirement not to produce certain products could be understood to fall within the prohibition in paragraph 11(e) against "in any way" designating the products to be produced, it clarifies that negative requirements are permitted. The United States submits that, in the light of the broad prohibition in paragraph 11(e), "the requirement in paragraph 11(b) ... could be understood to preclude conditioning payment on not producing certain products since this could be understood as in some way designating the products to be produced".<sup>334</sup> This required the explicit cross-reference to paragraph 11(e). According to the United States, because the same considerations do not apply in the case of paragraph 6(b), no specific authorization of partial prohibitions on production is required, as it remains implicit in the text of the provision.<sup>335</sup>

338. We are not persuaded by this argument. Like Brazil, we believe that a more compelling reason for the specific authorization of negative requirements not to produce a particular crop may be found in the fact that paragraph 11 addresses "structural adjustment", which may be achieved only by providing financial incentives to shift production away from certain products. In our view, the considerations submitted by the United States do not render the meaning of the terms used in paragraph 11(b) different from the meaning of the same terms as used in paragraph 6(b).

339. Finally, we note that the United States has also argued that the Panel's interpretation, with which we agree, would require a Member to continue to make decoupled income support payments, even if a producer's production is *illegal*, for example involving the production of opium poppy, unapproved biotech varieties or environmentally-damaging production.<sup>336</sup> According to the United States, this is a logical consequence of a finding that, to comply with paragraph 6(b) of Annex 2, a measure may not condition payments upon the non-production of certain products, while permitting production of others.

340. In our view, questions regarding the problem of illegal production contrast starkly with the situation addressed in the present case. It remains perfectly *legal* for a holder of upland cotton base acres to grow fruits, vegetables or wild rice in the United States. The consequence of growing such crops is simply the reduction or elimination of production flexibility contract or direct payments to the holders of upland cotton base acres. Our interpretation of paragraph 6(b) would not prevent a WTO

<sup>333</sup> Paragraph 11(a) of Annex 2 to the *Agreement on Agriculture*.

<sup>334</sup> United States' appellant's submission, paras. 45-47.

<sup>335</sup> *Ibid.*, para. 47.

<sup>336</sup> *Ibid.*, paras. 53-55 and footnote 45.

Member from making illegal the production of certain crops. Nor would it prevent a Member from providing decoupled income support while at the same time making the production of certain crops illegal. As Brazil states, there is nothing in the *Agreement on Agriculture* to suggest that the term "production" in paragraph 6 of Annex 2 refers to anything other than *lawful* production.<sup>337</sup> In addition, we observe that specific provisions of the *Agreement on Agriculture* recognize, and exempt from reduction commitments, domestic support programs that address the problem of production of illicit narcotic crops in developing countries<sup>338</sup> or payments under certain environmental programs.<sup>339</sup>

#### 4. Conclusion

341. For all these reasons, we *uphold* the Panel's finding in paragraphs 7.388, 7.413, 7.414 and 8.1(b) of the Panel Report that conditioning production flexibility contract payments and direct payments on a producer's compliance with planting flexibility limitations regarding certain products, coupled with the flexibility to produce certain other products, means that the amount of payments under those measures is related to the type of production undertaken by a producer after the base period, within the meaning of paragraph 6(b) of Annex 2 of the *Agreement on Agriculture*.

342. Accordingly, we also *uphold* the Panel's finding, in paragraphs 7.413 and 7.414 of the Panel Report, that production flexibility contract payments and direct payments are not "decoupled income support" within the meaning of paragraph 6, are not green box measures exempt from the reduction commitments by virtue of Annex 2 of the *Agreement on Agriculture*, and are not, therefore, sheltered from challenge by virtue of paragraph (a) of Article 13 of the *Agreement on Agriculture*. Rather, these measures are support covered by the chapeau to paragraph (b) of Article 13, and are to be taken into account in the analysis of that provision.

#### B. *Article 13(a) of the Agreement on Agriculture – Base Period Update*

343. The Panel indicated that it had "already found that [direct] payments fail to conform to the provisions of paragraph 6 of Annex 2 due to the planting flexibility limitations". For this reason, it indicated that it was "therefore unnecessary for the purposes of this dispute to make findings on their conformity with paragraph 6 due to the updating" of base acres.<sup>340</sup> Brazil conditionally appeals the Panel's exercise of judicial economy on the issue of whether the base period update under the direct

<sup>337</sup> Brazil's appellee's submission, para. 315.

<sup>338</sup> Article 6.2 of the *Agreement on Agriculture* exempts from domestic support reduction commitments that would otherwise be applicable "domestic support to producers in developing country Members to encourage diversification from growing illicit narcotic crops".

<sup>339</sup> See paragraph 12 of Annex 2 to the *Agreement on Agriculture*.

<sup>340</sup> Panel Report, para. 7.393.

payments program is consistent with paragraph 6(a) of Annex 2.<sup>341</sup> Brazil's appeal is conditional on the Appellate Body reversing the Panel's finding that direct payments, the legislative and regulatory provisions that establish and maintain the direct payments program, as well as payments under the production flexibility contract program, do not fall within the terms of paragraph (a) of Article 13 because they are not consistent with paragraph 6(b) of Annex 2.

344. Having upheld the Panel's finding under paragraph 6(b) of Annex 2 of the *Agreement on Agriculture*, the condition upon which Brazil's appeal regarding the updating of base acres under paragraph 6(a) rests is not fulfilled. It is therefore unnecessary for us to address this issue further.

C. *Article 13(b) of the Agreement on Agriculture – Non-Green Box Domestic Support*

1. Introduction

345. Having rejected the United States' appeal of the Panel's finding that production flexibility contract payments under the FAIR Act of 1996 and direct payments under the FSRI Act of 2002 are not green box measures sheltered from challenge by the provisions of Article 13(a) of the *Agreement on Agriculture*, we now turn to consider the United States' appeal regarding the application of Article 13(b) of the *Agreement on Agriculture*.

346. Article 13 of the *Agreement on Agriculture* is entitled "Due Restraint" and applies during the implementation period.<sup>342</sup> Article 13(b) of the *Agreement on Agriculture* provides, in relevant part:

[D]omestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, shall be:

...

- (ii) exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year, ...

<sup>341</sup>Brazil's other appellant's submission, paras. 237 ff.

<sup>342</sup>The "implementation period" during which Article 13 applies is defined in Article 1(f) of the *Agreement on Agriculture* as "the nine-year period commencing in 1995". "Year", for purposes of Article 1(f) "and in relation to the specific commitments of a Member" is defined in Article 1(i) and "refers to the calendar, financial or marketing year specified in the Schedule relating to that Member".

347. Subparagraph (ii) to Article 13(b) exempts non-green box domestic support measures described in the chapeau from actions based on Article XVI:1 of GATT 1994 and Articles 5 and 6 of the *SCM Agreement*. This exemption is, however, subject to a proviso and is thus made conditional upon a requirement that "such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year". The dispute in the present appeal relates to the interpretation and application of this proviso to certain United States domestic support measures.<sup>343</sup>

348. Before the Panel, the United States claimed that its non-green box domestic support measures did not "grant support to a specific commodity in excess of that decided during the 1992 marketing year" and thus were consistent with the proviso to subparagraph (ii) of Article 13(b) of the *Agreement on Agriculture*. Hence, they were entitled to the exemption from action provided by Article 13(b).<sup>344</sup>

349. The Panel rejected the United States' argument that its measures did not "grant support to a specific commodity in excess of that decided during the 1992 marketing year". The Panel calculated values of support that were "decided during the 1992 marketing year" (the "1992 benchmark") as well as values of support by which the measures at issue "gran[de]d] support to a specific commodity"—namely, upland cotton—in each of the years 1999, 2000, 2001, and 2002 ("implementation period support"). The Panel tabulated support attributable to upland cotton under the relevant United States domestic support measures and concluded that the support granted in each relevant year of the implementation period exceeded the 1992 benchmark.<sup>345</sup> Accordingly, the Panel found that:

Brazil has discharged its burden to show that the United States domestic support measures at issue grant support to a specific commodity in excess of that decided during the 1992 marketing year.<sup>346</sup>

<sup>343</sup>Step 2 payments to domestic users; marketing loan program payments; production flexibility contract payments; market loss assistance payments; direct payments; counter-cyclical payments; crop insurance payments; and, cottonseed payments for the 2000 crop. (Panel Report, para. 7.337)

<sup>344</sup>The Panel noted that Brazil did not claim that the United States' domestic support measures do not comply with the conditions set out in the chapeau of Article 13(b). (Panel Report, paras. 7.415-7.416)

<sup>345</sup>*Ibid.*, paras. 7.596-7.597. The Panel indicated that the United States' implementation period support exceeded the 1992 benchmark regardless of whether, for certain price-based support measures, budgetary outlays or price gap methodology was used. (*Ibid.*, para. 7.597)

<sup>346</sup>*Ibid.*, para. 7.598.

350. After finding that evidence and arguments presented by the United States did not rebut Brazil's case<sup>347</sup>, the Panel concluded:

[i]n light of the above findings, ... that the [relevant] United States domestic support measures ... grant support to a specific commodity in excess of that decided during the 1992 marketing year and that, therefore, they are not exempt from actions based on paragraph 1 of Article XVI of the *GATT 1994* or Articles 5 and 6 of the *SCM Agreement*.<sup>348</sup>

2. Appeal by the United States

351. The United States appeals the Panel's finding that its relevant domestic support measures granted, during the implementation period, "support to a specific commodity in excess of that decided during the 1992 marketing year", and the consequential finding that these measures are therefore susceptible to challenge under the actionable subsidies provisions of Articles 5 and 6 of the *SCM Agreement* and Article XVI:1 of the *GATT 1994*.

352. The United States challenges, in particular, two elements of the Panel's reasoning. The United States first appeals the Panel's *interpretation* of the phrase "grant support to a specific commodity" in the proviso to Article 13(b)(ii), and, in particular, its finding that four types of payments made with respect to historical production of upland cotton—production flexibility contract payments, market loss assistance payments, direct payments and counter-cyclical payments—grant support to the specific commodity upland cotton, even though producers have flexibility under these programs to grow crops other than upland cotton or not to plant any crop at all. According to the United States, properly construed, the phrase "support to a specific commodity" refers to "product-specific support"<sup>349</sup>, which would exclude payments under these "non-product-specific" base acre dependent measures.<sup>350</sup> It adds that, even if the Panel is correct in its interpretation that "support to a specific commodity" refers to all "non-green box support measures that clearly or explicitly define a commodity as one to which they bestow or confer support"<sup>351</sup>, the Panel erred in the application of its test by allocating to upland cotton all payments to historic upland cotton base acres under these four programs, including those that went to planted commodities other than upland cotton.<sup>352</sup>

<sup>347</sup>Panel Report, para. 7.607.

<sup>348</sup>*Ibid.*, para. 7.608.

<sup>349</sup>United States' appellant's submission, para. 93.

<sup>350</sup>*Ibid.*, para. 105.

<sup>351</sup>Panel Report, para. 7.494(i).

<sup>352</sup>United States' appellant's submission, paras. 101-107.

353. Secondly, the United States contests the Panel's use of budgetary outlay methodology to measure the value of support, for purposes of the comparison envisaged by Article 13(b)(ii), of two types of price-based payments: marketing loan program payments and deficiency payments.<sup>353</sup> In this regard, the United States argues that the Panel erred in reading the word "grant" in Article 13(b)(ii) as meaning something actually provided, and not in harmony with the term "decided".<sup>354</sup> The United States argues that this led the Panel erroneously to conclude that it could use a calculation methodology other than the price-gap methodology described in paragraph 10 of Annex 3 to the *Agreement on Agriculture* to measure the value of these price-based measures. According to the United States, only the price gap methodology can reflect the nature of the support "decided" under these programs because it filters out fluctuations in market prices; indeed, only the price gap methodology can measure those aspects of support that the government of a Member can control.<sup>355</sup>

354. The United States, having "corrected" the Panel's calculations for its alleged errors using its own methodologies, asserts that its domestic support measures at issue did not grant a level of product-specific support in any relevant year of the implementation period in excess of the 1992 benchmark.<sup>356</sup> On this basis, the United States argues that its domestic support measures are consistent with the proviso to Article 13(b)(ii) of the *Agreement on Agriculture* and are, therefore, exempt from challenge under the peace clause.<sup>357</sup>

355. Brazil argues that if the Appellate Body upholds the Panel's finding with respect to the interpretation of the phrase "support to a specific commodity" and thereby finds that production flexibility contract payments, market loss assistance payments, direct payments and counter-cyclical payments cannot be excluded from the calculation of support under Article 13(b)(ii), then, regardless of the methodology used to calculate the value of marketing loan program payments and deficiency payments, the United States measures would still exceed the 1992 benchmark.<sup>358</sup> Brazil contends that the Panel was correct to find that "support to a specific commodity" does not mean "product-specific support", or support that is directed specifically at only one product, but may capture all "non-green

<sup>353</sup>Marketing loan program payments in respect of both the 1992 benchmark and the implementation period support, and deficiency payments in respect of the 1992 benchmark only. (United States' appellant's submission, para. 72)

<sup>354</sup>*Ibid.*, paras. 64-68. The United States reiterates this argument in the section of its appellant's submission dealing with the interpretation of the phrase "support to a specific commodity": see *ibid.*, paras. 114-116.

<sup>355</sup>*Ibid.*, paras. 69-75.

<sup>356</sup>*Ibid.*, paras. 120-122.

<sup>357</sup>*Ibid.*, paras. 122-124.

<sup>358</sup>Brazil's appellee's submission, para. 330.

box measures, that clearly or explicitly define a commodity as one to which they bestow or confer support".<sup>359</sup>

356. Brazil also contends that the Panel was correct to use budgetary outlays for its analysis of the United States' price-based measures. Brazil observes that paragraph 10 of Annex 3 of the *Agreement on Agriculture* permits, in principle, the use of *either* budgetary outlays or the price gap methodology for payments based on price gaps.<sup>360</sup> There is thus no textual basis to say that only price gaps may be used to measure these types of payments. Brazil also submits that the Panel correctly found that the term "grant" refers to what a measure actually provides<sup>361</sup>, and therefore contests the United States' claim that factors beyond the control of government, such as market price fluctuations, must be filtered out of the analysis envisaged by the proviso to Article 13(b)(ii) through use of the price gap methodology.<sup>362</sup> Brazil also points out that the United States notified the level of support conferred by the marketing loan program for purposes of its base level Aggregate Measurement of Support ("AMS"), as well as in subsequent AMS notifications, through use of a budgetary outlay methodology.<sup>363</sup> According to Brazil, WTO Members should be able to rely upon AMS notifications to determine whether the notifying Member was entitled, during the implementation period, to the protection conferred by the peace clause.

357. Finally, Brazil illustrates that, even using the price gap methodology to calculate the level of support under the deficiency payment and marketing loan payment programs, total United States support still exceeded the 1992 benchmark in each relevant year of the implementation period.<sup>364</sup>

### 3. Analysis

358. The United States appeals the Panel's finding that the United States' non-green box domestic support measures granted "support to a specific commodity", namely, upland cotton, during the implementation period, "in excess of that decided during the 1992 marketing year", and the consequential finding that this support was therefore not sheltered from challenge under Article XVI:1 of the GATT 1994 or Articles 5 and 6 of the *SCM Agreement*. The United States' appeal in this regard has two dimensions. First, the United States challenges the Panel's *interpretation* of the phrase "support to a specific commodity" used in the proviso to Article 13(b)(ii) and its *application*

<sup>359</sup>Brazil's appellee's submission, paras. 369 and 385 (quoting Panel Report, para. 7.481).

<sup>360</sup>*Ibid.*, para. 350.

<sup>361</sup>*Ibid.*, paras. 344 ff.

<sup>362</sup>*Ibid.*, paras. 346 and 351.

<sup>363</sup>*Ibid.*, paras. 352 ff.

<sup>364</sup>*Ibid.*, paras. 442-445.

to four of the domestic support measures. These measures are production flexibility contract payments, market loss assistance payments, direct payments, and counter-cyclical payments.<sup>365</sup> The question whether or not these four measures grant "support to a specific commodity" is at the heart of the difference between the participants in regard to the comparison contemplated by Article 13(b) of the *Agreement on Agriculture*.<sup>366</sup> Secondly, the United States takes issue with the Panel's adoption of a budgetary outlay *methodology* to measure the value of two price-based support measures for the comparison under the proviso to Article 13(b)(ii).

#### (a) Interpretation of "Support to Specific Commodity"

359. We address first the meaning of the phrase "support to a specific commodity" in Article 13(b)(ii). We then discuss the application of this interpretation to four domestic support measures: production flexibility contract payments<sup>367</sup>, market loss assistance payments<sup>368</sup>, direct payments<sup>369</sup> and counter-cyclical payments<sup>370</sup>. These four measures did not exist in 1992. Therefore, this part of the United States' appeal affects the calculation of *only* the support granted during the implementation period.<sup>371</sup>

<sup>365</sup>The United States characterizes these measures as "decoupled" from production. (United States' appellant's submission, para. 104)

<sup>366</sup>On the basis that these four measures are not "support to a specific commodity", the United States has assigned zero values to them in its calculations under the proviso to Article 13(b)(ii). (*Ibid.*, para. 120)

<sup>367</sup>We describe briefly production flexibility contract payments *supra*, para. 311.

<sup>368</sup>Market loss assistance payments were provided to recipients of production flexibility contract payments through *ad hoc* legislation as additional assistance to producers to make up for losses caused by low commodity prices. Market loss assistance payments were proportionate to the production flexibility contract payments made to the recipient, and the amount paid depended on the amount allocated to market loss assistance payments for the relevant crop year. Accordingly, eligibility criteria for the market loss assistance payments were, essentially, the same as for the production flexibility contract payments. (See Panel Report, paras. 7.216-7.217)

<sup>369</sup>We describe briefly direct payments *supra*, para. 312.

<sup>370</sup>Counter-cyclical payments supplement, for covered commodities, direct payments and any payments made under the marketing loan program. The eligibility requirements and planting flexibility requirements are the same as under the direct payment program, and they are also dependent on base acres. Counter-cyclical payments supplement producer incomes by filling the gap between, on the one hand, the market price and payments under the marketing loan program and the direct payments program and, on the other hand, a target price established for upland cotton at 72.4 cents per pound. (See Panel Report, paras. 7.223-7.226)

<sup>371</sup>We observe that the United States does not dispute that other payments, namely those under the marketing loan program (for a description of marketing loan program payments, see Panel Report, paras. 7.204-7.208), Step 2 payments (for a description of Step 2 payments, see Panel Report, paras. 7.209-7.211), deficiency payments (for a description of deficiency payments, see Panel Report, footnote 294 to para. 7.213), and cottonseed payments (for a description of cottonseed payments, see Panel Report, paras. 7.233-7.235), result in "support to a specific commodity". (United States' appellant's submission, para. 120 and Table 2) Nor does the United States appeal the Panel's finding that the crop insurance program (for a description of the crop insurance program, see Panel Report, paras. 7.227-7.232) results in "support to a specific commodity", although it adds that it disagrees with the conclusion of the Panel. (See United States' appellant's submission, footnote 134)

360. We note that payments in respect of each of these measures are calculated by reference to "base acres" upon which certain commodities (including upland cotton) were grown in a base period, but upon which a producer currently may or may not grow upland cotton. We refer to these four types of payment in this section as the "base acre dependent payments".

361. We turn to our analysis of the phrase "such measures ... grant[ing] support to a specific commodity" in Article 13(b)(ii). The Panel found and the participants do not dispute that the relevant United States measures grant "support"<sup>372</sup>; similarly, the Panel found<sup>373</sup> and the participants agree<sup>374</sup> that upland cotton is a "commodity" in the sense of that provision.

362. The key element, however, is the significance of the qualifying word "specific" in this phrase. The Panel described the ordinary meaning of the term "specific" as "clearly or explicitly defined; precise; exact; definite"<sup>375</sup> and as "specially or peculiarly pertaining to a particular thing or person, or a class of these; peculiar (*to*)".<sup>376</sup> In our view, the term "specific" in the phrase "support to a specific commodity" means the "commodity" must be clearly identifiable. The use of term "to" connecting "support" with "a specific commodity" means that support must "specially pertain" to a particular commodity in the sense of being conferred on that commodity. In addition, the terms "such measures ... grant" indicates that a discernible link must exist between "such measures" and the particular commodity to which support is granted. Thus, it is not sufficient that a commodity happens to benefit from support, or that support ends up flowing to that commodity by mere coincidence. Rather, the phrase "such measures" granting "support to a specific commodity" implies a discernible link between the support-conferring measure and the particular commodity to which support is granted.

363. Therefore, we agree with the Panel insofar as it found that the ordinary meaning of the phrase "such measures ... grant[ing] support to a specific commodity" includes "non-green box measures

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<sup>372</sup>See Panel Report, paras. 7.518-7.520 and, for example, United States' appellant's submission, para 105. We recognize that the United States qualifies this by emphasizing that, in its view, they grant "non-product-specific" support.

<sup>373</sup>Panel Report, paras. 7.480 and 7.518-7.520.

<sup>374</sup>See United States' appellant's submission, paras. 85 and 104; and Brazil's appellee's submission, para. 385.

<sup>375</sup>Panel Report, para. 7.481 (quoting *The New Shorter Oxford English Dictionary*, L. Brown (ed.) (Clarendon Press, 1993), Vol. 2, p. 2972).

<sup>376</sup>*Ibid.*, para. 7.482 (quoting *The New Shorter Oxford English Dictionary*, L. Brown (ed.) (Clarendon Press, 1993), Vol. 2, p. 2972). The Panel found that this second definition was more appropriate in another context, but we believe that both of these definitions shed light upon the meaning of "specific" in "support to a specific commodity".

that clearly or explicitly define a commodity as one to which they bestow or confer support".<sup>377</sup> This is because the Panel's test requires that a commodity be specified in the measure, and that the support be conferred on that commodity. We believe, however, that the terms of this definition do not exhaust the scope of measures that may grant "support to a specific commodity". We note in this regard that the Panel looked, in applying its test, to factors such as eligibility criteria and payment rates, as well as the relationship between payments and current market prices of the commodity in question.<sup>378</sup> In our view, the Panel was correct to consider such matters, as the requisite link between a measure granting support and a specific commodity may be discerned not just from an explicit specification of the commodity in the text of a measure, as the Panel's test—on its face—seems to imply, but also from an analysis of factors such as the characteristics, structure or design of that measure.<sup>379</sup>

364. Moving to the context of the proviso to Article 13(b)(ii), we note that the United States argues that "support to a specific commodity" should be interpreted as meaning "product-specific support". The United States emphasizes the similarities between the phrase "support to a specific commodity" in Article 13(b)(ii) and two phrases in Article 1 of the *Agreement on Agriculture* that refer to product-specific support: "support for basic agricultural products"<sup>380</sup> and "support ... provided for an agricultural product in favour of the producers of the basic agricultural product".<sup>381</sup> The United States argues that the meaning of all of these phrases must be the same.

365. These phrases do provide important context for the interpretation of Article 13(b)(ii). In our view, "support to a specific commodity" certainly includes "product-specific" support. However, like the Panel, we do not believe that the scope of the phrase "support to a specific commodity" in the proviso to Article 13(b)(ii) is exhausted by taking into account the category of product-specific support alone.

366. This is for at least two reasons. First, we note that the drafters chose *not* to use phrases such as support "provided for an agricultural product in favour of the producers of the basic agricultural product" or "support for basic agricultural products" in Article 13(b)(ii), but rather chose the distinct

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<sup>377</sup>Panel Report, para. 7.494(i).

<sup>378</sup>*Ibid.*, paras. 7.510-7.517.

<sup>379</sup>Although we observe that the Panel correctly identified the elements that we believe are inherent in the term "support to a specific commodity", the Panel's articulation of the test was not absolutely clear. We also note that the Panel appears to have misapplied the test for "support to a specific commodity" by attributing to upland cotton the total budgetary outlays with respect to upland cotton base acres. See *infra*, para. 375.

<sup>380</sup>This phrase is found in Article 1(h) of the *Agreement on Agriculture*. (United States' appellant's submission, para. 88)

<sup>381</sup>This phrase is found in Article 1(a) of the *Agreement on Agriculture*. (United States' appellant's submission, para. 88)

phrase "support to a specific commodity". This choice of different words by the drafters gives a preliminary indication that they may have intended to convey different meanings.<sup>382</sup>

367. Secondly, and more importantly, the United States' argument fails to reckon with the fact that the scope of domestic support measures that may grant "support to a specific commodity" under Article 13(b)(ii) is broader than just "product-specific support" in the sense of Article 1 and Annex 3. The proviso to Article 13(b)(ii) mentions only the term "such measures" granting support; but the meaning of this term can be clarified by reference to the chapeau of Article 13(b) because, as the Panel noted, "[t]he chapeau of paragraph (b) and subparagraph (ii) form part of a single sentence."<sup>383</sup> The chapeau identifies the categories of support measures covered by that provision. These are:

... domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member's Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6 ...

368. Measures covered by Article 6 include both product-specific and non-product-specific amber box support subject to reduction commitments. In addition, measures covered by the chapeau *also* include product-specific and non-product-specific support within *de minimis* levels. They further include blue box support provided in accordance with Article 6.5, as well as development box support, provided according to the provisions of Article 6.2, for both of which the distinction between product-specific and non-product specific support for purposes of the AMS calculation has little practical relevance.<sup>384</sup> Like the Panel, we believe that the use of the term "such measures" in the proviso to Article 13(b)(ii) indicates that all such measures identified in the chapeau of Article 13(b) may qualify as granting "support to a specific commodity" and are eligible to be included in the analysis. By contrast, under the United States' argument, domestic support measures listed in the chapeau (with the exception of product-specific amber box support) could not be "support to a specific commodity" even if they confer support on a specific commodity and there is a discernible link between the measure and that commodity.

<sup>382</sup>We note in this regard that, for example, Article 6.4(a)(i) of the *Agreement on Agriculture* mentions "product-specific domestic support", whereas Article 13 does not mention or cross-refer to it.

<sup>383</sup>Panel Report, para. 7.470.

<sup>384</sup>The only type of domestic support clearly excluded from support covered by Article 13(b) is green box support, which does not need to conform with the provisions of Article 6, but rather must conform with the provisions of Annex 2. Green box support, however, qualifies for the exemption from actions provided by Article 13(a).

369. In addition, the United States supports its position by reference to the obligations in Articles 3 and 6 of the *Agreement on Agriculture*, which lay down reduction commitments for total AMS comprising both product-specific and non-product-specific support, but provide no product-specific caps. In the United States' view, because the reduction commitments do not cap product-specific support, the proviso in Article 13(b)(ii) disciplines the degree to which a Member that is in conformity with its reduction commitments can shift support between particular commodities.<sup>385</sup>

370. Indeed, as the United States correctly points out, Article 13(b)(ii) serves to create a discipline upon Members that seek the shelter of the peace clause during the implementation period. We are not convinced, however, that this discipline is limited to "product-specific support" as defined in Article 1 of the *Agreement on Agriculture*. Rather, it extends to all measures that grant "support to a specific commodity", in the sense that the support is conferred on a specific commodity, and there is a discernible link between the measure and the specific commodity concerned.

(b) Application of Article 13(b)(ii) to the Measures at Issue

371. The proviso to Article 13(b)(ii) requires an assessment of whether the relevant United States non-green box domestic support measures grant, during the implementation period, "support to a specific commodity in excess of that decided during the 1992 marketing year".

372. As we have explained above, the term "such measures ... grant support to a specific commodity" comprises two elements: first, a non-green box measure actually confers support on the specific commodity in question; and second, there is a discernible link between the measure and the commodity, such that the measure is directed at supporting that commodity. Such a discernible link may be evident where a measure explicitly defines a specific commodity as one to which it bestows support. Such a link might also be ascertained, as a matter of fact, from the characteristics, structure or design of the measure under examination. Conversely, support that does not actually flow to a commodity or support that flows to a commodity by coincidence rather than by the inherent design of the measure cannot be regarded as falling within the ambit of the term "support to a specific commodity".

373. With these considerations in mind, we turn now to the application of this interpretation to four measures that the United States claims do not grant "support to a specific commodity": the *production flexibility contract payments*, *market loss assistance payments*, *direct payments* and *counter-cyclical payments*. We refer to these measures as "base acre dependent payments" because each of these measures provides payments based on a calculation in which a payment rate, specific to

<sup>385</sup>United States' appellant's submission, para. 98.

upland cotton, is multiplied by an ascertained quantity of upland cotton, which, in turn, is a product of a farm's historical planting of upland cotton (its "upland cotton base acres") and its historical yield of upland cotton per acre.<sup>386</sup> For purposes of the Article 13(b)(ii) comparison, the Panel outlined three alternative methodologies, and therefore three different calculations, in respect of these measures in its Article 13(b)(ii) analysis.<sup>387</sup> We also note that in calculating support granted to upland cotton the United States has ascribed a zero value to the four aforementioned domestic support measures. For purposes of these proceedings, we do not find it necessary to go beyond the Panel record, and thus limit our consideration to these four alternative calculations.

374. The Panel ultimately based its calculations in respect of the base acre dependent payments on the *total* budgetary outlays with respect to upland cotton base acres under each program.<sup>388</sup> The United States contends that this calculation methodology led the Panel to include, as support to upland cotton, payments to producers who did not plant upland cotton.<sup>389</sup> For the United States, there is "[no] question that payments cannot be deemed to grant support to a crop the recipient does not produce".<sup>390</sup> In addition, the United States contends that the Panel erred in finding that the base acre dependent programs "clearly and explicitly specify] upland cotton ... as a commodity to which they grant support".<sup>391</sup> In the view of the United States, these measures do no such thing. The United States emphasizes that producers receive payments under the base acre dependent programs irrespective of whether and how much upland cotton they plant, and regardless of whether they plant anything at all.<sup>392</sup> For the United States, the "Panel's error stems largely from its assertion that merely identifying *historical* criteria relating to a commodity according to which payments will be made would render such payments 'support to a specific commodity'".<sup>393</sup>

<sup>386</sup>We note that each of these programs applied not just to upland cotton, but also to other eligible commodities. We also note that market loss assistance payments did not involve a separate calculation involving these criteria. Rather, market loss assistance payments served to supplement production flexibility contract payments and were made proportionate to a producer's production flexibility contract payments. (Panel Report, para. 7.2117)

<sup>387</sup>See Panel Report, para. 7.596 and "Attachment to Section VII.D" (Panel Report, paras. 7.634-7.647).

<sup>388</sup>*Ibid.*, paras. 7.580-7.583.

<sup>389</sup>United States' appellant's submission, para. 106.

<sup>390</sup>*Ibid.*

<sup>391</sup>*Ibid.*, para. 103 (quoting Panel Report, para. 7.518).

<sup>392</sup>United States' appellant's submission, para. 104.

<sup>393</sup>*Ibid.*, para. 105. (original emphasis) The United States points out that "base acres" are not "physical acres" but hypothetical acres for calculation of decoupled payments to producers, who are free to produce whatever crop they choose or to produce no crop at all. (United States' responses to questions during the oral hearing)

375. We agree with the United States that payments made with respect to historical upland cotton base acres to commodities other than upland cotton or to producers who produced no commodities at all cannot be deemed to be support granted to upland cotton for purposes of the Article 13(b)(ii) comparison. The Article 13(b)(ii) assessment must be limited to support conferred on planted upland cotton; support flowing to other commodities that were planted, or support that was given where no commodities were produced must of course be removed from the assessment. We reject, therefore, the Panel's calculation methodology to the extent that it failed to limit the Article 13(b)(ii) calculation to payments with respect to upland cotton base acres corresponding to physical acres actually planted with upland cotton.

376. We observe, however, that the Panel acknowledged that a producer with upland cotton base acres may plant any crop other than the excluded fruits, vegetables, and wild rice, but it found that there was "a strongly positive relationship between those recipients who hold upland cotton base acres and those who continue to plant upland cotton, despite their entitlement to plant other crops".<sup>394</sup> The Panel further observed that data provided by the United States showed that "a very large proportion of farms with upland cotton base acres continue to plant upland cotton in the year of payment"<sup>395</sup>, and that "the overwhelming majority of farms enrolled in the programmes which plant upland cotton also hold upland cotton base".<sup>396</sup>

377. We note in this regard that the Panel included, in "Attachment to Section VII.D" to its Report, and described as "appropriate"<sup>397</sup>, an alternative calculation using certain methodologies submitted by Brazil for allocating support to acres actually planted with upland cotton under the base acre dependent programs. The first part of this calculation, the "cotton to cotton" methodology, allocated, for each *planted* acre of upland cotton, payments associated with one upland cotton base acre. The second part ("Brazil's methodology") took the results of the "cotton to cotton" methodology and then added to it payments made with respect to non-upland cotton base acres corresponding to physical acres that were actually planted with upland cotton.<sup>398</sup> The "cotton to cotton" methodology limits the Article 13(b)(ii) calculation to payments with respect to cotton base acres corresponding to physical acres that were actually planted with upland cotton.

378. We turn next to the United States' contention that the mere fact that a measure is based on *historical* production of upland cotton is not a sufficient basis for a finding that the measure grants at

<sup>394</sup>Panel Report, para. 7.637.

<sup>395</sup>*Ibid.*, para. 7.636. (footnote omitted)

<sup>396</sup>*Ibid.*, para. 7.636.

<sup>397</sup>*Ibid.*, para. 7.646.

<sup>398</sup>See *Ibid.*, paras. 7.640-7.642.

present "support to [the] specific commodity" upland cotton. We agree that none of the base acre dependent programs expressly ties support to continued production of upland cotton. However, the absence of an express reference in the legislation to continued production of upland cotton does not mean that the payments do not grant support to upland cotton. This is because a link between the four measures at issue and the continued production of upland cotton is discernible from the characteristics, structure and operation of those measures.

379. We note in this regard the reasoning of the Panel:

Where, for example, these measures specify commodities in the eligibility criteria and payment rates, they constitute support to the commodities specified in that way. This applies *a fortiori* where the payments are determined according to, or are related to, current market prices of the specific commodities.<sup>399</sup>

On this basis, the Panel highlighted several factors revealing a close nexus between payments with respect to historic upland cotton base acres under the production flexibility contract, market loss assistance, direct payment and counter-cyclical payment measures, and the continued production of upland cotton on an equivalent number of physical acres at present. The Panel noted that payments under each program were based on "very specific eligibility criteria", primarily the production of upland cotton in a historical base period.<sup>400</sup> The Panel also observed that, in the case of each of the measures, a particular payment rate was specified for upland cotton.<sup>401</sup> Yield calculations were also specific to upland cotton and related to historical upland cotton yields per acre.<sup>402</sup> In the case of market loss assistance payments, payments were specifically designed to compensate for low prices for upland cotton.<sup>403</sup> In the case of counter-cyclical payments, the payment rate for upland cotton is directly linked to the market price of upland cotton in the year of payment.<sup>404</sup> In our view, these characteristics and operational factors of the measures in question demonstrate a link between payments made with respect to historic upland cotton base acres and the continued production of upland cotton.

380. We underline that these Panel findings do not pertain to *all* payments to *current* producers of upland cotton, but rather are limited to payments to producers with respect to historic *upland*

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<sup>399</sup>Panel Report, para. 7.484.

<sup>400</sup>*Ibid.*, paras. 7.513-7.516.

<sup>401</sup>*Ibid.*, para. 7.635.

<sup>402</sup>See *ibid.*, paras. 7.513-7.516.

<sup>403</sup>*Ibid.*, para. 7.515.

<sup>404</sup>*Ibid.*, para. 7.516.

*cotton* base acres.<sup>405</sup> Indeed, we see little in the Panel's finding or on the record that would allow us to discern a link between the support-conferring measures with respect to non-cotton historical base acres and current production of upland cotton. We do not, therefore, accept the methodology submitted by Brazil that included, in the Article 13(b)(ii) calculation, payments with respect to both cotton and non-cotton base acres flowing to current production of upland cotton. We believe that only the "cotton to cotton" methodology, included by the Panel in "Attachment to Section VII:D" to its Report as an "appropriate"<sup>406</sup> alternative calculation, sufficiently demonstrates a discernible link between payments under base acre dependent measures (related to upland cotton) and upland cotton.

381. Finally, we address the United States' argument that the calculation methodology under Article 13(b)(ii) must be based on only those factors that the government of a Member can control, excluding, for example, producer decisions regarding what crops to grow within the scope of production flexibility allowed by the measures.<sup>407</sup> In advancing this contention, the United States relies upon the following statement of the Panel:

[I]f the proviso [to Article 13(b)(ii)] focused on where support was spent due to reasons beyond the control of the government, such as producer decisions on what to produce within a programme, it would introduce a major element of unpredictability into Article 13, and render it extremely difficult to ensure compliance.<sup>408</sup>

382. The United States finds support for this view in the terms "grant" and "decided" in Article 13(b)(ii), and claims that "the focus of the Peace Clause comparison is on the support a Member decides".<sup>409</sup> We note that the verbs "grant" and "decided" have distinct meanings. We agree with the observation of the Panel that "[d]ecided" refers to what the government determines, but 'grant' refers to what its measures provide.<sup>410</sup> In Article 13(b)(ii), each of these words has been chosen to govern one side of the comparison required by that proviso. In the light of the distinct meanings of these words, and the distinct roles they play in the context of Article 13(b)(ii), we reject the idea that the word "grant", which is applicable to implementation period support, must be read to mean the same thing as "decided", which is applicable to the 1992 benchmark level of support.

383. Moreover, we do not accept that unpredictability of producer decisions under planting flexibility rules, *per se*, could modify the specific requirements set out in the proviso to

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<sup>405</sup>See *supra*, footnote 184.

<sup>406</sup>Panel Report, para. 7.646.

<sup>407</sup>United States appellant's submission, paras. 64-67 and 114-117.

<sup>408</sup>Panel Report, para. 7.487.

<sup>409</sup>United States appellant's submission, para. 66.

<sup>410</sup>Panel Report, para. 7.476.

Article 13(b)(ii). What is relevant for the comparison is the support that the measure actually grants during the implementation period. Indeed, we agree with Brazil that a certain degree of unpredictability in the volume of the payments flowing to particular commodities is inherent in many of the support measures disciplined by the *Agreement on Agriculture*, including measures granting support to a specific commodity.<sup>411</sup> The existence of such unpredictability cannot be a ground to alter the basis of comparison under the proviso to Article 13(b)(ii) from what is actually "grant[ed]" in the implementation period to what is only "decided".

384. For the reasons stated above, we conclude that payments with respect to upland cotton base acres to producers currently growing upland cotton under the production flexibility contract, market loss assistance, direct payment and counter-cyclical payment measures, calculated in accordance with the "cotton to cotton" methodology, are support granted to the specific commodity upland cotton in the sense of Article 13(b)(ii) of the *Agreement on Agriculture*.<sup>412</sup>

(c) Methodology for Calculating the Value of Price-Based Payments

385. The United States' appeal regarding the Panel's decision to use the budgetary outlay methodology and not the price gap methodology described in paragraph 10 of Annex 3 to the *Agreement on Agriculture* for certain price-based payments concerns calculation of the amounts of two types of payments: (i) payments under the *marketing loan program*, which are relevant to the calculation of both the 1992 benchmark level of support and support during the implementation period; and (ii) *deficiency payments*, made in accordance with the FACT Act of 1990, which were replaced by production flexibility contract payments under the FAIR Act of 1996, and which are therefore relevant only to the calculation of the 1992 benchmark level of support.<sup>413</sup>

<sup>411</sup> Thus, in the case of measures that compensate for price fluctuations, unless a limit is set on total payments, a government has little control over the eventual amount of payments. In addition, we recall that the export subsidies at issue in *US – FSC* took the form of a foregoing of tax revenue, with the precise amount of the revenue foregone, and the nature of the specific products that it went to support, being dependent upon the actions of private corporations claiming the exemption. In that case, therefore, it could also be said that whether the United States would exceed product-specific export subsidy commitments would also depend on private producers' decisions to claim tax exemptions.

<sup>412</sup> For the Panel's findings on the value of production flexibility contract payments, market loss assistance payments, direct payments and counter-cyclical payments using the "cotton to cotton" methodology see Panel Report, para. 7.641.

<sup>413</sup> United States' appellant's submission, para. 72; Panel Report, para. 7.213. We observe that the United States' arguments relating to the use of the price gap methodology to measure marketing loan program payments and deficiency payments extend only to the analysis required under Article 13(b)(ii) of the *Agreement on Agriculture*; the United States does not argue that a price gap calculation is required in the context of an analysis of significant price suppression under Article 6.3(c) of the *SCM Agreement*.

386. Payments to upland cotton under the marketing loan program could take one of several forms. In each case, however, gains to producers under this program accrued on the basis of a gap between a reference price tied to the market price of upland cotton, known as the "adjusted world price", and the "loan rate" fixed, from time to time, for the marketing loan program.<sup>414</sup> Deficiency payments for upland cotton were based on the gap between either the loan rate under the marketing loan program, or the national average market price for upland cotton (whichever was higher) and a target price of 72.9 cents per pound of upland cotton. In the event that the loan rate or market price fell below the target price, deficiency payments filled the deficit.<sup>415</sup>

387. The United States claims that both of these price-based measures represent "non-exempt direct payments ... dependent on a price gap", the value of which should be calculated by reference to the price gap methodology described in paragraph 10 of Annex 3 to the *Agreement on Agriculture*.<sup>416</sup>

388. In addressing this issue, we—like the Panel—note that Article 13(b)(ii) gives no specific guidance regarding *how* the "support" that measures granted in the implementation period or that was decided during the 1992 marketing year should be calculated. The Panel therefore turned to the broader context of the *Agreement on Agriculture* and chose to "apply the principles of AMS methodology" in accordance with Annex 3 of the *Agreement on Agriculture*, with certain modifications.<sup>417</sup> We observe that, on appeal, neither of the participants, nor indeed any of the third participants that addressed this issue, suggested that the Panel erred in seeking guidance for its calculations in the principles set out in Annex 3.

389. Against this background, we observe that paragraph 10 of Annex 3 provides that "non-exempt direct payments ... dependent on a price gap" may be measured using either price gap methodology or budgetary outlay methodology.<sup>418</sup> The Panel chose to rely upon actual budgetary outlays<sup>419</sup>, but

<sup>414</sup> For a description of payments under the marketing loan program, see Panel Report, paras. 7.204-7.208.

<sup>415</sup> For a description of deficiency payments, see Panel Report, footnote 294 to para. 7.213.

<sup>416</sup> United States' appellant's submission, paras. 71-73 (quoting paragraph 10 of Annex 3 to the *Agreement on Agriculture*).

<sup>417</sup> Panel Report, para. 7.552.

<sup>418</sup> Paragraph 10 of Annex 3 to the *Agreement on Agriculture* sets forth:

Non-exempt direct payments: non-exempt direct payments which are dependent on a price gap shall be calculated either using the gap between the fixed reference price and the applied administered price multiplied by the quantity of production eligible to receive the administered price, or using budgetary outlays.

<sup>419</sup> See, for example, Panel Report, para. 7.596. We reproduce the Panel's findings with respect to the values attributable to deficiency payments and payments under the marketing loan program using budgetary outlays in Table 1 of Annex 2.

included in its Report findings regarding the value of support in each relevant year calculated according to price gap methodology as well.<sup>420</sup>

390. As we explain in the next section, our conclusion that the United States granted, during the relevant years of the implementation period, "support to a specific commodity", namely, upland cotton, "in excess of that decided during the 1992 marketing year" holds irrespective of whether the Panel's budgetary outlay calculations or its price gap calculations are used to attribute values to marketing loan program payments and deficiency payments. Therefore, it is unnecessary for us to decide here which methodology must be used for purposes of the comparison envisaged by Article 13(b)(ii) with respect to these two types of payment.<sup>421</sup>

(d) Conclusion Regarding the Application of Article 13(b)(ii)

391. We recall, once again, that the proviso to Article 13(b)(ii) of the *Agreement on Agriculture* sets forth that, during the implementation period in which Article 13 applies, non-green box domestic support measures must not "grant support to a specific commodity in excess of that decided during the 1992 marketing year", if such measures are to enjoy exemption from actions "based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement".<sup>422</sup>

392. In our review above, we have concluded that, for purposes of the comparison envisaged by Article 13(b)(ii), the values of the four measures, namely, production flexibility contract payments, market loss assistance payments, direct payments and counter-cyclical payments in the years 1999, 2000, 2001, and 2002 are properly determined by using the "cotton to cotton" methodology, and we have therefore modified the Panel's findings in this regard. We further note that the United States has

<sup>420</sup>See Panel Report, para. 7.564 and footnote 727 to para. 7.565. We reproduce the Panel's findings with respect to the values attributable to deficiency payments and payments under the marketing loan program using price gap methodology in each relevant year in Table 2 of Annex 2.

<sup>421</sup>At the oral hearing, the United States confirmed that it may become unnecessary to rule on its appeal regarding calculation methodology, should the Panel's conclusions with respect to the phrase "support to a specific commodity" in Article 13(b)(ii) be upheld by the Appellate Body. (United States' response to questioning at the oral hearing)

<sup>422</sup>We note at this point that we agree with the Panel that:

There is no requirement to quantify the excess, but the decisive question is whether there is any excess. Thus, it would not be strictly necessary ... to make a precise calculation of the amount of the excess if it is clear that, on the basis of the proper evidentiary standard, there is an excess of some degree.

(Panel Report, para. 7.419)

We also note, however, that fairly detailed calculations regarding the values attributable to United States implementation period support is available to us in these proceedings.

not appealed the Panel's findings regarding the values attributable to three further support measures, namely, Step 2 payments to domestic users, crop insurance and cottonseed payments.<sup>423</sup>

393. Adding to the values of the seven measures mentioned above, the values for deficiency payments and marketing loan program payments calculated using *either* budgetary outlays<sup>424</sup> or price gap methodology<sup>425</sup>, we conclude that the United States' domestic support measures in question granted "support to a specific commodity", namely, upland cotton, that was "in excess of that decided during the 1992 marketing year" in each relevant year of the implementation period.

394. It follows that the condition set out in the proviso to Article 13(b)(ii) of the *Agreement on Agriculture* has not been met by the United States. We *uphold*, therefore, the Panel finding, in paragraph 7.608 of its Report, that the United States' domestic support measures challenged by Brazil are not entitled to the exemption provided by the peace clause from actions under Article XVI:1 of the GATT 1994 and Articles 5 and 6 of the *SCM Agreement*.

**VI. Serious Prejudice**

A. *Significant Price Suppression under Article 6.3(c) of the SCM Agreement*

1. Introduction

395. The United States appeals the Panel's finding, in paragraphs 7.1416 and 8.1(g)(i) of the Panel Report, that the effect of marketing loan program payments, Step 2 payments, market loss assistance payments, and counter-cyclical payments (the "price-contingent subsidies") is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement* constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*. The United States raises several objections to the Panel's analysis leading to this finding. The United States also asks us to find that the Panel failed to set out the findings of fact, the applicability of relevant provisions, and the basic rationale behind this finding, as required by Article 12.7 of the DSU. Brazil, for its part, raises a preliminary issue under Article 11 of the DSU.

396. In this section of this Report, we begin our analysis by addressing the preliminary argument of Brazil regarding Article 11 of the DSU. We then turn to the various errors that the United States alleges that the Panel made in making its finding of significant price suppression under Article 6.3(c) of the *SCM Agreement*. In doing so, we examine the United States' objections to the "market" and

<sup>423</sup>For Panel findings on the value of support under these programs, see Panel Report, para. 7.596. See also Tables 1 and 2 of Annex 2.

<sup>424</sup>See Table 1 of Annex 2.

<sup>425</sup>See Table 2 of Annex 2.

"price" that the Panel examined in its analysis of the price-contingent subsidies pursuant to Article 6.3(c). We then consider the Panel's order of analysis under Article 6.3(c). Next, we assess the other alleged errors in the Panel's reasoning leading to its finding that the effect of the price-contingent subsidies is significant price suppression. These include the Panel's alleged failure to quantify the amount of the price-contingent subsidies benefiting upland cotton or to allocate the effect of the subsidies to the appropriate period of time. We then consider the implications of this appeal for the Panel's finding regarding serious prejudice under Article 5(c) of the *SCM Agreement*. Finally, we address the United States' claim that the Panel failed to comply with the requirements of Article 12.7 of the DSU.

2. Objective Assessment under Article 11 of the DSU

397. Brazil argues that many of the United States' arguments, particularly those concerning serious prejudice, involve allegations that the Panel failed to "make an objective assessment of the matter before it, including an objective assessment of the facts of the case" pursuant to Article 11 of the DSU.<sup>426</sup> Brazil requests us to dismiss the United States' arguments that Brazil lists in Annex A to its appellee's submission, on the basis that the United States has not made a proper claim of error under Article 11 of the DSU.<sup>427</sup>

398. In its opening statement delivered at the oral hearing, the United States confirmed that it has not made an Article 11 claim in this appeal. Rather, the United States claims that the Panel erred in its interpretation of Article 6.3(c) of the *SCM Agreement* and in applying this interpretation to the facts in this dispute. The United States also requests us not to dismiss certain of its arguments as requested by Brazil. Under these circumstances, there is no need for us to rule that the United States makes no Article 11 claim. We also refrain from ruling on whether the Panel complied with Article 11 of the DSU. Moreover, we decline to dismiss the United States' arguments that Brazil lists in Annex A to its appellee's submission on the basis that an Article 11 claim was not properly set out by the United States.

399. We are nevertheless mindful of the scope of appellate review with respect to legal and factual matters. Pursuant to Article 17.6 of the DSU, appeals are "limited to issues of law covered in the panel report and legal interpretations developed by the panel". To the extent that the United States' arguments concern the Panel's appreciation and weighing of the evidence, we note from the outset that

<sup>426</sup>Brazil's appellee's submission, paras. 105 and 146.

<sup>427</sup>*Ibid.*, para. 146.

the Appellate Body will not interfere lightly with the Panel's discretion "as the trier of facts".<sup>428</sup> At the same time, the Appellate Body has previously pointed out that the "consistency or inconsistency of a given fact or set of facts with the requirements of a given treaty provision is ... a legal characterization issue".<sup>429</sup> Whether the Panel properly interpreted the requirements of Article 6.3(c) of the *SCM Agreement* and properly applied that interpretation to the facts in this case is a legal question. This question is different from whether the Panel made "an objective assessment of the matter before it, including an objective assessment of the facts of the case", in accordance with Article 11 of the DSU.<sup>430</sup> Therefore, the Panel's application of the legal requirements of Article 6.3(c) of the *SCM Agreement* to the facts of this case falls within the scope of our review in this appeal, despite the fact that the United States does not claim that the Panel erred under Article 11 of the DSU.

3. Relevant Market under Article 6.3(c) of the SCM Agreement

400. Turning to the question of the relevant "market", we observe that Article 6.3(c) of the *SCM Agreement* addresses the situation where "the effect of the subsidy is ... significant price suppression ... in the same market". (emphasis added) As the Panel suggested<sup>431</sup>, and the parties agree<sup>432</sup>, it is up to the complaining Member to identify the market in which it alleges that the effect of a subsidy is significant price suppression and to demonstrate that the subsidy has that effect within the meaning of Article 6.3(c). Before the Panel, Brazil identified the following as relevant markets for its claim under Article 6.3(c): (a) the world market for upland cotton; (b) the Brazilian market; (c) the United States market; and (d) 40 third country markets where Brazil exports its cotton and where United States and Brazilian upland cotton are found.<sup>433</sup> In contrast, the United States argued before the Panel that the relevant market under Article 6.3(c) must be "a particular domestic market of a Member", and that it cannot be a "world market".<sup>434</sup>

<sup>428</sup>Determination of the credibility and weight properly to be ascribed to (that is, the appreciation of) a given piece of evidence is part and parcel of the fact finding process and is, in principle, left to the discretion of a panel as the trier of facts." (Appellate Body Report, *EC – Hormones*, para. 132). See also Appellate Body Report, *US – Wheat Gluten*, para. 151; Appellate Body Report, *EC – Sardines*, para. 299; Appellate Body Report, *US – Carbon Steel*, para. 142; Appellate Body Report, *Japan – Apples*, para. 221.

<sup>429</sup>Appellate Body Report, *EC – Hormones*, para. 132.

<sup>430</sup>On this question, the Appellate Body has made several pronouncements in previous appeals. See, for example, Appellate Body Report, *EC – Hormones*, para. 133; Appellate Body Report, *Korea – Dairy*, para. 137; Appellate Body Report, *Japan – Apples*, para. 222.

<sup>431</sup>Panel Report, para. 7.1246.

<sup>432</sup>The United States and Brazil indicated their agreement on this point in response to questioning during the oral hearing.

<sup>433</sup>Panel Report, para. 7.1230.

<sup>434</sup>*Ibid.*, para. 7.1231.

401. The Panel regarded the absence of any geographic limitation or reference to imports or exports in the text of Article 6.3(c), in contrast to Articles 6.3(a) and (b) and 15.2 of the *SCM Agreement*, as indicating that the "same market" under Article 6.3(c) could be a "world market".<sup>435</sup> Applying this interpretation to the facts of the present dispute, the Panel concluded that a "world market" for upland cotton does exist.<sup>436</sup> The Panel further stated that "[w]here price suppression is demonstrated in [the world] market, it may not be necessary to proceed to an examination of each and every other possible market where the products of both the complaining and defending Members are found".<sup>437</sup> In the present dispute, having found that "price suppression has occurred in the same world market"<sup>438</sup>, the Panel decided that it was not "necessary to proceed to any further examination of ... alleged price suppression in individual country markets".<sup>439</sup> Thus, the Panel's analysis of the world market for upland cotton formed the basis for its finding that the effect of the price-contingent subsidies is significant price suppression within the meaning of Article 6.3(c).

402. On appeal, the United States submits that the Panel erred in interpreting the words "same market" in Article 6.3(c) of the *SCM Agreement* as including a "world market".<sup>440</sup> It also submits that the Panel's finding that a "world market" exists for upland cotton is inconsistent with certain of its other findings.<sup>441</sup> The United States also argues that, in any case, the Panel did not make a finding that United States and Brazilian upland cotton compete in the world market that it had identified for upland cotton.<sup>442</sup> Brazil contends that significant price suppression under Article 6.3(c) "may apply to any 'market,' from local to global, and everything in between".<sup>443</sup>

403. We begin our analysis of this issue by identifying the ordinary meaning of the word "market" in the context of Article 6.3(c). Article 6.3(c) of the *SCM Agreement* indicates that:

Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply:

...

<sup>435</sup> Panel Report, paras. 7.1238-7.1240.

<sup>436</sup> *Ibid.*, para. 7.1247.

<sup>437</sup> *Ibid.*, para. 7.1252.

<sup>438</sup> *Ibid.*, para. 7.1312.

<sup>439</sup> *Ibid.*, para. 7.1315.

<sup>440</sup> United States' appellant's submission, para. 307.

<sup>441</sup> *Ibid.*, paras. 318 and 319. The United States submits that the Panel failed to reconcile its interpretation of the "same market" in Article 6.3(c) with its reading of the phrase "world market" under Article 6.3(d).

<sup>442</sup> United States' appellant's submission, para. 321.

<sup>443</sup> Brazil's appellee's submission, para. 628. (original emphasis)

(c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market[.] (emphasis added)

404. The Panel described the ordinary meaning of the word "market" as:<sup>444</sup>

"a place ... with a demand for a commodity or service"<sup>1355</sup>; "a geographical area of demand for commodities or services"; "the area of economic activity in which buyers and sellers come together and the forces of supply and demand affect prices".<sup>1356</sup>

<sup>1355</sup> *The New Shorter Oxford English Dictionary*, (1993).

<sup>1356</sup> *Merriam-Webster Dictionary online*.

405. We accept that this is an adequate description of the ordinary meaning of the word "market" for the purposes of this dispute, and we do not understand the parties to dispute it.<sup>445</sup> This ordinary meaning does not, of itself, impose any limitation on the "geographical area" that makes up any given market. Nor does it indicate that a "world market" cannot exist for a given product. As the Panel indicated, the "degree to which a market is limited by geography will depend on the product itself and its ability to be traded across distances".<sup>446</sup>

406. The only express qualification on the type of "market" referred to in Article 6.3(c) is that it must be "the same" market. Aside from this qualification (to which we return below), Article 6.3(c) imposes no explicit geographical limitation on the scope of the relevant market. This contrasts with the other paragraphs of Article 6.3: paragraph (a) restricts the relevant market to "the market of the subsidizing Member"; paragraph (b) restricts the relevant market to "a third country market"; and paragraph (d) refers specifically to the "world market share". We agree with the Panel<sup>447</sup> that this difference may indicate that the drafters did not intend to confine, *a priori*, the market examined under Article 6.3(c) to any particular area. Thus, the ordinary meaning of the word "market" in Article 6.3(c), when read in the context of the other paragraphs of Article 6.3, neither requires nor excludes the possibility of a national market or a world market.<sup>448</sup>

<sup>444</sup> Panel Report, para. 7.1236.

<sup>445</sup> As indicated by the United States and Brazil in response to questioning during the oral hearing.

<sup>446</sup> Panel Report, para. 7.1237.

<sup>447</sup> *Ibid.*, paras. 7.1238-7.1240.

<sup>448</sup> This stands to reason, given that the purpose of the "actionable subsidies" provisions in Part III of the *SCM Agreement* is to prevent Members from causing adverse effects to the interests of other Members through the use of specific subsidies, wherever such effects may occur.

407. Turning to the phrase "in the same market", it is clear to us from a plain reading of Article 6.3(c) that this phrase applies to all four situations covered in that provision, namely, "significant price undercutting", "significant price suppression, price depression [and] lost sales". We read the Panel Report and the participants' submissions as endorsing this interpretation.<sup>449</sup> The phrase "in the same market" suggests that the subsidized product in question (United States upland cotton in this case)<sup>450</sup> and the relevant product of the complaining Member must be "in the same market". In this appeal, the Panel and the participants agree that United States upland cotton<sup>451</sup> and Brazilian upland cotton<sup>452</sup> must be "in the same market" for Brazil's claim under Article 6.3(c) to succeed.<sup>453</sup> Furthermore, the participants agree that these are like products.<sup>454</sup>

408. When can two products be considered to be "in the same market" for the purposes of a claim of significant price suppression under Article 6.3(c)? Article 6.3(c) does not provide an explicit answer. However, recalling that one accepted definition of "market" is "the area of economic activity in which buyers and sellers come together and the forces of supply and demand affect prices"<sup>455</sup>, it seems reasonable to conclude that two products would be in the same market if they were engaged in actual or potential competition in that market. Thus, two products may be "in the same market" even if they are not necessarily sold at the same time and in the same place or country. As the Panel correctly pointed out, the scope of the "market", for determining the area of competition between two products, may depend on several factors such as the nature of the product, the homogeneity of the conditions of competition, and transport costs.<sup>456</sup> This market for a particular product could well be a

<sup>449</sup>Panel Report, paras. 7.1248 and 7.1251; United States' appellant's submission, para. 310; Brazil's appellee's submission, paras. 636 and 638.

<sup>450</sup>See *infra*, footnote 451.

<sup>451</sup>Specifically, the subsidized product is United States upland cotton lint. (Panel Report, paras. 7.139, 7.1221-7.1224 and footnote 191 to para. 7.139) The Panel explained that upland cotton, upon harvest, comprises cotton lint and cottonseed. The cotton lint is separated from the cottonseed through "ginning". (Panel Report, footnote 258 to para. 7.197)

<sup>452</sup>Panel Report, footnote 258 to para. 7.197 and paras. 7.1221-7.1224. The United States and Brazil confirmed during the oral hearing that they do not contest this identification of the subsidized product and the other relevant product.

<sup>453</sup>Accordingly, we need not decide whether, in a claim of significant price suppression under Article 6.3(c), the product identified by the complainant must be "like" the relevant subsidized product. We note in this regard that the term "in the same market" appears twice in Article 6.3(c). In the case of *significant price undercutting*, the "subsidized product" must be "compared with the price of a *like product* of another Member in the same market" (emphasis added). This raises the question whether the other three situations mentioned in Article 6.3(c) (namely, "significant price suppression, price depression [and] lost sales") include a requirement that the subsidized product and the relevant product of the complainant be "like".

<sup>454</sup>Panel Report, paras. 7.1248 and 7.1251; United States' appellant's submission, para. 310; Brazil's appellee's submission, paras. 636 and 638.

<sup>455</sup>Panel Report, para. 7.1236 (quoting *Merriam-Webster Dictionary online*).

<sup>456</sup>Panel Report, para. 7.1237 and footnote 1357 to para. 7.1240.

"world market". However, we agree with the Panel that the fact that a world market exists for one product does not necessarily mean that such a market exists for every product.<sup>457</sup> Thus the determination of the relevant market under Article 6.3(c) of the *SCM Agreement* depends on the subsidized product in question. If a world market exists for the product in question, Article 6.3(c) does not exclude the possibility of this "world market" being the "same market" for the purposes of a significant price suppression analysis under that Article.

409. According to the United States, if the market examined pursuant to a claim of significant price suppression under Article 6.3(c) is a "world market", then the subsidized product and any like product will necessarily be in that market and the word "same" in Article 6.3(c) would have no meaning.<sup>458</sup> We do not agree with this argument. As we have explained above, there is no *per se* geographical limitation of a market under Article 6.3(c). It could well be a national market, a world market, or any other market. It is for the complaining party to identify the market where it alleges significant price suppression and to establish that that market exists. In doing so, it is for the complaining party to establish that the subsidized product and its product are in actual or potential competition in that alleged market. If that market is established to be a "world market", it cannot be said, for that reason alone, that the two products are not in the "same market" within the meaning of Article 6.3(c).

410. For these reasons, we agree with the Panel that, depending on the facts of the case, a "world market" may be the "same market" for the purposes of a claim of significant price suppression under Article 6.3(c) of the *SCM Agreement*.<sup>459</sup>

411. We now examine the United States' objection to the Panel's examination of the "world market for upland cotton"<sup>460</sup> in the particular circumstances of this dispute. The United States submits that the Panel's finding that a world market for upland cotton exists is inconsistent with the Panel's suggestion that the United States price for upland cotton is different from the "world price" represented by the A-Index.<sup>461</sup> Essentially, the United States appears to argue that no world market for upland cotton can exist if there is no world price for upland cotton. In our view, whether a world market for upland cotton and a world price for upland cotton exist in the circumstances of this case

<sup>457</sup>*Ibid.*, footnote 1357 to para. 7.1240.

<sup>458</sup>"One can speak of a 'same' regional or national market because there are 'other' regional or national markets where the subsidized and like product may (or may not) compete. One cannot speak of a 'same' world market in the same way because there is no 'other' world market where the products can be found." (United States' appellant's submission, para. 311)

<sup>459</sup>Panel Report, paras. 7.1238-7.1244.

<sup>460</sup>*Ibid.*, paras. 7.1247 and 7.1274.

<sup>461</sup>United States' appellant's submission, para. 319 (referring to Panel Report, para. 7.1213).

are factual questions. The Panel Report indicates that the Panel examined the evidence before it and concluded on the basis of that evidence that a world market for upland cotton exists<sup>462</sup> and that a world price in that market also exists and is reflected in the A-Index.<sup>463</sup> We see no reason to disturb the Panel's findings of fact in this regard.<sup>464</sup>

412. The United States also contends that the Panel did not make a finding that United States and Brazilian upland cotton were both in the world market that it had identified for upland cotton.<sup>465</sup> As we explained earlier<sup>466</sup>, the words "in the same market" in Article 6.3(c) of the *SCM Agreement* mean that subsidized United States upland cotton and Brazilian upland cotton must be engaged in actual or potential competition in the market in which the effect of the challenged subsidy is alleged to be significant price suppression. In this regard, we note that the Panel expressly stated that the market it examined pursuant to Article 6.3(c) had to be a market "in which both Brazilian and United States upland cotton were present and competing for sales"<sup>467</sup> and "where competition exists between Brazilian and United States upland cotton."<sup>468</sup>

413. Whether or not Brazilian and United States upland cotton competed in the "world market for upland cotton"<sup>469</sup> during the period the Panel examined is a factual question. As we stated earlier<sup>470</sup>, two products may be "in the same market" even if they are not necessarily sold in the same place and at the same time, as long as they are engaged in actual or potential competition. We recall that, in addition to the "world market", Brazil identified "40 third country markets ... where United States and Brazilian like upland cotton is found".<sup>471</sup> We also note that, based on an assessment of the relevant facts, the Panel concluded, as a matter of fact, that these two products did compete in the world

<sup>462</sup>Panel Report, paras. 7.1245-7.1252.

<sup>463</sup>*Ibid.*, paras. 7.1260-7.1274. The Panel's "four main reasons" for this conclusion regarding the A-Index were: prices of Brazilian and United States upland cotton are "constituent elements" of the A-Index; "key market participants" perceive the A-Index as reflecting the world market price for upland cotton; the International Cotton Advisory Council treats the A-Index in a similar manner; and the Economic Research Service of the United States Department of Agriculture (the "USDA") has itself referred to the A-Index as the world price. In addition, "the United States 'adjusted world price' is based on and derived from the A-Index." (*Ibid.*, paras. 7.1265-7.1271) (original emphasis)

<sup>464</sup>See Appellate Body Report, *EC – Hormones*, para. 132. See also Appellate Body Report, *US – Wheat Gluten*, para. 151.

<sup>465</sup>United States' appellant's submission, para. 320.

<sup>466</sup>*Supra*, paras. 407-408.

<sup>467</sup>Panel Report, para. 7.1248.

<sup>468</sup>*Ibid.*, para. 7.1251.

<sup>469</sup>*Ibid.*, paras. 7.1247 and 7.1274.

<sup>470</sup>*Supra*, para. 408.

<sup>471</sup>Panel Report, para. 7.1230.

market for upland cotton. In particular, the Panel referred to "the world upland cotton market, and the relative proportion of that market enjoyed by the United States and Brazil".<sup>472</sup>

414. We are therefore not persuaded by the United States' arguments that the Panel erred with respect to whether United States and Brazilian upland cotton were "in the same market" according to Article 6.3(c).

4. Relevant Price under Article 6.3(c) of the *SCM Agreement*

415. We now turn to the United States' arguments on appeal with respect to the relevant "price" under Article 6.3(c). The Panel found that "the A-Index can be taken to reflect a world price in the world market for upland cotton that is sufficient to form the basis for our analysis as to whether there is price suppression in the same world market within the meaning of Article 6.3(c) for the purposes of this dispute".<sup>473</sup> The United States argues that, even if the Panel properly found that the effect of the price-contingent subsidies is significant suppression of the *world price* for upland cotton, this could not constitute significant price suppression for purposes of Brazil's claim under Article 6.3(c) of the *SCM Agreement*. According to the United States, Brazil had to show that the effect of the challenged subsidies is significant suppression of "the price of Brazilian upland cotton in the 'world market'."<sup>474</sup>

416. We have already found that the "market" referred to in Article 6.3(c), in connection with significant price suppression, can be a "world market"<sup>475</sup>, and that the Panel was correct in examining the world market for upland cotton in the present dispute.<sup>476</sup> The question before us is whether it was sufficient for the Panel to analyze the price of upland cotton in general in the world market or whether the Panel was required to analyze the price of Brazilian upland cotton in the world market and find significant price suppression with respect to that price.

417. In our view, it was sufficient for the Panel to analyze the price of upland cotton in general in the world market. The Panel did so by relying on the A-Index. The Panel specifically found, based on its reading of the evidence before it:

<sup>472</sup>*Ibid.*, para. 7.1313. See also *ibid.*, para. 7.1246.

<sup>473</sup>Panel Report, para. 7.1274. According to the Panel, the "A-Index" "is a composite of an average of the five lowest price quotes from a selection of the principal upland cottons traded in the world market obtained by Cotlook, a private UK-based organization". (Panel Report, para. 7.1264)

<sup>474</sup>United States' appellant's submission, para. 239.

<sup>475</sup>*Supra*, para. 410.

<sup>476</sup>*Supra*, para. 414.

[P]rices for upland cotton transactions throughout the world are ... largely determined by the A-Index price.<sup>477</sup>

Therefore, the Panel found that the A-Index adequately reflected prices in the world market for upland cotton.<sup>478</sup> The Panel also found that "developments in the world upland cotton price would inevitably affect prices" wherever Brazilian and United States upland cotton compete, "due to the nature of the world prices in question and the nature of the world upland cotton market, and the relative proportion of that market enjoyed by the United States and Brazil".<sup>479</sup> It was not necessary, in these circumstances, for the Panel to proceed to a separate analysis of the prices of Brazilian upland cotton in the world market.

418. For these reasons, we reject the United States' contention that the Panel erred in its analysis of significant price suppression under Article 6.3(c) of the *SCM Agreement* "in not examining Brazilian upland cotton prices in the 'world market'".<sup>480</sup>

5. Significant Price Suppression as the Effect of the Price-Contingent Subsidies

(a) Introduction

419. We now address the reasons the Panel provided for its ultimate finding under Article 6.3(c). First, the Panel found that price suppression had occurred within the meaning of Article 6.3(c)<sup>481</sup> after examining three main considerations: "(a) the relative magnitude of the United States' production and exports in the world upland cotton market; (b) general price trends [in the world market as revealed by the A-Index]; and (c) the nature of the subsidies at issue, and in particular, whether or not the nature of these subsidies is such as to have discernible price suppressive effects".<sup>482</sup> Next, the Panel found that the price suppression it had found to exist was "significant" price suppression under Article 6.3(c)<sup>483</sup>, "given the relative magnitude of United States production and exports, the overall price trends we identified in the world market, ... the nature of the mandatory United States subsidies in question ... and the readily available evidence of the order of magnitude of the subsidies".<sup>484</sup>

<sup>477</sup>Panel Report, para. 7.1311.

<sup>478</sup>*Ibid.*, para. 7.1274.

<sup>479</sup>*Ibid.*, para. 7.1313.

<sup>480</sup>United States' appellant's submission, para. 238.

<sup>481</sup>Panel Report, para. 7.1312.

<sup>482</sup>*Ibid.*, para. 7.1280.

<sup>483</sup>*Ibid.*, para. 7.1333.

<sup>484</sup>Panel Report, para. 7.1332. (footnotes omitted) We address the United States' arguments regarding the magnitude or quantification of the subsidies *infra*, paras. 459-472.

420. The Panel went on to find that "a causal link exists between" the price-contingent subsidies and the significant price suppression it had found<sup>485</sup>, for four main reasons:<sup>486</sup>

[T]he United States exerts a substantial proportionate influence in the world upland cotton market.<sup>487</sup>

[T]he [price-contingent subsidies] are directly linked to world prices for upland cotton, thereby insulating United States producers from low prices.<sup>488</sup>

[T]here is a discern[ible] temporal coincidence of suppressed world market prices and the price-contingent United States subsidies.<sup>489</sup>

[C]redible evidence on the record concerning the divergence between United States producers' total costs of production and revenue from sales of upland cotton since 1997 ... supports the proposition that United States upland cotton producers would not have been economically capable of remaining in the production of upland cotton had it not been for the United States subsidies at issue and that the effect of the subsidies was to allow United States producers to sell upland cotton at a price lower than would otherwise have been necessary to cover their total costs.<sup>490</sup>

421. Finally, the Panel found that the following "other causal factors alleged by the United States"<sup>491</sup> "do not attenuate the genuine and substantial causal link that we have found between the United States mandatory price-contingent subsidies at issue and the significant price suppression. Nor do they reduce the effect of the mandatory price-contingent subsidies to a level which cannot be considered 'significant'":<sup>492</sup>

[W]eakness in world demand for cotton due to competing, low-priced synthetic fibres, and weak world economic growth.<sup>493</sup>

[B]urgeoning United States textile imports, reflecting the strong United States dollar since the mid-1990's and declining United States competitiveness in textile and apparel production[.]<sup>494</sup>

<sup>485</sup>Panel Report, para. 7.1355.

<sup>486</sup>*Ibid.*, para. 7.1347.

<sup>487</sup>*Ibid.*, para. 7.1348.

<sup>488</sup>*Ibid.*, para. 7.1349.

<sup>489</sup>*Ibid.*, para. 7.1351.

<sup>490</sup>*Ibid.*, para. 7.1353. (footnotes omitted)

<sup>491</sup>*Ibid.*, para. 7.1357.

<sup>492</sup>*Ibid.*, para. 7.1363.

<sup>493</sup>Panel Report, para. 7.1358.

<sup>494</sup>*Ibid.*, para. 7.1359.

[T]he strong United States dollar since the mid-1990[s].<sup>495</sup>

China subsidized the release of millions of bales of government stocks between 1999 and 2001[.]<sup>496</sup>

[U]pland cotton planting decisions ... are driven by other factors such as (1) the effect of technological factors of upland cotton production ... (2) the relative movement of upland cotton prices *vis-à-vis* prices of competing crops ... (3) the expected prices for the upcoming crop year.<sup>497</sup>

(b) Appeal by the United States

422. In addition to the alleged errors already discussed in connection with the relevant "market" and "price", the United States contends on appeal that the Panel erred in finding that the effect of the price-contingent subsidies is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*.<sup>498</sup> These errors, according to the United States, are:

- (a) in relation to the effects of the price-contingent subsidies:
  - (i) failing to analyze "the relevant production decision faced by farmers – that is, the decision on what to plant"<sup>499</sup>;
  - (ii) ignoring data indicating that United States upland cotton production responded to market signals<sup>500</sup>;
  - (iii) "failing to examine supply response in other countries – that is, to what extent other countries would increase supply in response to any alleged decrease in cotton production resulting from the absence of U.S. payments"<sup>501</sup>; and
  - (iv) "the four main, cumulative grounds the Panel identified supporting a finding of causation do not withstand scrutiny"<sup>502</sup>;

<sup>495</sup> *Ibid.*, para. 7.1360.

<sup>496</sup> *Ibid.*, para. 7.1361.

<sup>497</sup> *Ibid.*, para. 7.1362.

<sup>498</sup> *Ibid.*, paras. 7.1416 and 8.1(e)(i).

<sup>499</sup> United States' appellant's submission, paras. 136 and 154.

<sup>500</sup> *Ibid.*, para. 155.

<sup>501</sup> United States' appellant's submission, para. 227.

<sup>502</sup> *Ibid.*, para. 180.

(b) in relation to the quantification of subsidies:

- (i) "accepting Brazil's argument that, for purposes of a serious prejudice claim, Brazil need not allege and demonstrate, and the Panel need not find, the amount of the challenged subsidy that benefits upland cotton"<sup>503</sup>;
  - (ii) finding "that subsidies not tied to current production of upland cotton (decoupled payments) need not be allocated over the total sales of the recipients"<sup>504</sup>; and
  - (iii) failing to determine "the extent to which processed cotton benefits from subsidies provided with respect to raw cotton"<sup>505</sup>; and
- (c) in relation to the effect of subsidies over time:
- (i) concluding "that the payments need not be allocated to the marketing year to which they relate"<sup>506</sup>; and
  - (ii) "making a finding of present serious prejudice related to past recurring subsidy payments", in the absence of a finding "that the past recurring subsidy payments at issue (that is, those from marketing years 1999-2001) had continuing effects at the time of panel establishment"<sup>507</sup>.
- (c) Meaning of "Significant Price Suppression"

423. A central question before the Panel with regard to Article 6.3(c) of the *SCM Agreement* was whether the effect of the subsidy is "significant price suppression"<sup>508</sup>. It is worth setting out the Panel's understanding of the meaning of the term "price suppression". In explaining this term, the Panel stated, in paragraph 7.1277 of the Panel Report:

<sup>503</sup> *Ibid.*, para. 240.

<sup>504</sup> *Ibid.*, para. 264.

<sup>505</sup> *Ibid.*, para. 301.

<sup>506</sup> *Ibid.*, para. 277.

<sup>507</sup> *Ibid.*, para. 278.

<sup>508</sup> According to the Panel, Brazil claimed that certain United States subsidies "significantly suppressed" upland cotton prices" within the meaning of Article 6.3(c). (Panel Report, para. 7.1108(i))

Thus, "price suppression" refers to the situation where "prices" – in terms of the "amount of money set for sale of upland cotton" or the "value or worth" of upland cotton – either are prevented or inhibited from rising (i.e. they do not increase when they otherwise would have) or they do actually increase, but the increase is less than it otherwise would have been. *Price depression* refers to the situation where "prices" are pressed down, or reduced.<sup>1388</sup>

<sup>1388</sup> In the remainder of our analysis, we use the term "price suppression" to refer both to an actual decline (which otherwise would not have declined, or would have done so to a lesser degree) and an increase in prices (which otherwise would have increased to a greater degree). (emphasis added)

424. Although the Panel first identified "price suppression" and "price depression" as two separate concepts in paragraph 7.1277, footnote 1388 of the Panel Report suggests that, for its analysis, the Panel used the term "price suppression" to refer to both price suppression and price depression. We recognize that "the situation where 'prices' ... are prevented or inhibited from rising" and "the situation where 'prices' are pressed down, or reduced"<sup>509</sup> may overlap. Nevertheless, it would have been preferable, in our view, for the Panel to avoid using the term "price suppression" as short-hand for both price suppression and price depression, given that Article 6.3(c) of the *SCM Agreement* refers to "price suppression" and "price depression" as distinct concepts. We agree, however, that the Panel's description of "price suppression" in paragraph 7.1277 of the Panel Report reflects the ordinary meaning of that term, particularly when read in conjunction with the French and Spanish versions of Article 6.3(c)<sup>510</sup>, as required by Article 33(3) of the *Vienna Convention on the Law of Treaties* (the "*Vienna Convention*").<sup>511</sup>

425. The Panel described its task in assessing "price suppression" under Article 6.3(c) as follows:

We need to examine whether these prices were suppressed, that is, lower than they would have been without the United States subsidies in respect of upland cotton.<sup>512</sup>

426. As regards the word "significant" in the context of "significant price suppression" in Article 6.3(c), the Panel found that this word means "important, notable or consequential".<sup>513</sup>

<sup>509</sup>Panel Report, para. 7.1277.

<sup>510</sup>The French version states, in part, "la subvention ... a pour effet d'empêcher des hausses de prix ou de déprimer les prix ... dans une mesure notable"; the Spanish version states, in part, "la subvención ... tenga un efecto significativo de contención de la subida de los precios, reducción de los precios". (emphasis added)

<sup>511</sup>Done at Vienna, 23 May 1969, 1155 U.N.T.S. 331; 8 International Legal Materials 679. Article 33(3) provides: "The terms of the treaty are presumed to have the same meaning in each authentic text."

<sup>512</sup>Panel Report, para. 7.1288. See also *ibid.*, para. 7.1279.

427. Article 6.3(c) does not set forth any specific methodology for determining whether the effect of a subsidy is significant price suppression. There may well be different ways to make this determination. However, we find no difficulty with the Panel's approach in the particular circumstances of this dispute. We therefore turn to an examination of how the Panel carried out its assessment.

(d) Panel's Order of Analysis

428. In addressing Brazil's claims of serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*, the Panel began by examining whether the effect of the challenged subsidies was significant price suppression within the meaning of Article 6.3(c). The Panel explained that it adopted this order of analysis because both parties agreed that the Panel could not make an affirmative finding of serious prejudice under Article 5(c) without making an affirmative finding that the effect of the challenged subsidies is significant price suppression within the meaning of Article 6.3(c).<sup>514</sup> Neither party appeals this decision by the Panel.

429. Having determined the relevant products, market, and price, the Panel continued its analysis with respect to Article 6.3(c) in the following order:

Is there "price suppression"?<sup>515</sup>  
Is it "significant" price suppression?<sup>516</sup>  
"The effect of the subsidy"<sup>517</sup>

430. The United States contests the Panel's decision to address "significant price suppression" before addressing "the effect of the subsidy", arguing that "[a] finding of price suppression *without* any prior finding of 'the effect of the subsidy' would be meaningless; how could one know that prices were lower than they otherwise would have been without knowing what allegedly caused the prices to be lower?"<sup>518</sup> The United States also contends that the Panel used "circular" reasoning by assuming causation in finding price suppression and using its conclusion on price suppression to support its finding on causation (the effect of the subsidy).<sup>519</sup>

<sup>513</sup>*Ibid.*, para. 7.1326.

<sup>514</sup>*Ibid.*, para. 7.1228.

<sup>515</sup>*Ibid.*, heading (ii) to paras. 7.1275-7.1315.

<sup>516</sup>*Ibid.*, heading (iii) to paras. 7.1316-7.1333.

<sup>517</sup>*Ibid.*, heading (k) to paras. 7.1334-7.1363.

<sup>518</sup>United States' appellant's submission, para. 230. (original emphasis)

<sup>519</sup>*Ibid.*, para. 131.

431. As noted above, Article 6.3(c) is silent as to the sequence of steps to be followed in assessing whether the effect of a subsidy is significant price suppression. We note that Article 6.8 indicates that the existence of serious prejudice pursuant to Articles 5(c) and 6.3(c) is to be determined on the basis of information submitted to or obtained by the panel, including information submitted in accordance with Annex V of the *SCM Agreement*.<sup>520</sup> Annex V provides some limited guidance about the type of information on which a panel might base its assessment under Article 6.3(c). But we find little other guidance on this issue. The text of Article 6.3(c) does not, however, preclude the approach taken by the Panel to examine first whether significant price suppression exists and then, if it is found to exist, to proceed further to examine whether the significant price suppression is the effect of the subsidy. The Panel evidently considered that, in the absence of significant price suppression, it would not need to proceed to analyze the effect of the subsidy. We see no legal error in this approach.

432. One might contend that, having decided to separate its analysis of significant price suppression from its analysis of the effects of the challenged subsidies, the Panel's price suppression analysis should have addressed prices without reference to the subsidies and their effects. For instance, in its significant price suppression analysis, the Panel could have addressed purely price developments in the world market for upland cotton, such as whether prices fell significantly during the period under examination or whether prices were significantly lower during that period than other periods. Then, in its "effects" analysis, the Panel could have addressed causal factors related to the nature of the subsidies, their relationship to prices, their magnitude, and their impact on production and exports. In this causal analysis, the Panel could also have addressed factors other than the challenged subsidies that may have been suppressing the prices in question.

433. However, the ordinary meaning of the transitive verb "suppress" implies the existence of a subject (the challenged subsidies) and an object (in this case, prices in the world market for upland cotton). This suggests that it would be difficult to make a judgement on significant price suppression without taking into account the effect of the subsidies.<sup>521</sup> The Panel's definition of price suppression, explained above<sup>522</sup>, reflects this problem; it includes the notion that prices "do not increase when they *otherwise* would have" or "they do actually increase, but the increase is less than

it *otherwise* would have been".<sup>523</sup> The word "otherwise" in this context refers to the hypothetical situation in which the challenged subsidies are absent. Therefore, the fact that the Panel may have addressed some of the same or similar factors in its reasoning as to significant price suppression and its reasoning as to "effects" is not necessarily wrong.<sup>524</sup>

434. The specific factors that the Panel examined in determining whether or not "price suppression" had occurred were: "(a) the relative magnitude of the United States' production and exports in the world upland cotton market; (b) general price trends; and (c) the nature of the subsidies at issue, and in particular, whether or not the nature of these subsidies is such as to have discernible price suppressive effects".<sup>525</sup> In the absence of explicit guidance on assessing significant price suppression in the text of Article 6.3(c), we have no reason to reject the relevance of these factors for the Panel's assessment in the present case. An assessment of "general price trends"<sup>526</sup> is clearly relevant to significant price suppression (although, as the Panel itself recognized, price trends alone are not conclusive).<sup>527</sup> The two other factors—the nature of the subsidies and the relative magnitude of the United States' production and exports of upland cotton—are also relevant for this assessment. We are not persuaded that the fact that these latter factors were also considered in connection with the Panel's analysis of "the effect of the subsidy"<sup>528</sup> amounts to legal error for that reason alone.

<sup>523</sup>Panel Report, para. 7.1277. (emphasis added)

<sup>524</sup>An analysis under Article 6.3(c) *SCM Agreement* could involve assessing similar facts from different perspectives in order to answer different factual and legal questions when addressing "significant price suppression" and "the effect of" the challenged subsidies.

<sup>525</sup>Panel Report, para. 7.1280.

<sup>526</sup>*Ibid.*, para. 7.1286. See also *ibid.*, para. 7.1310.

<sup>527</sup>*Ibid.*, para. 7.1288.

<sup>528</sup>We discuss these factors *infra*, paras. 449 and 450.

<sup>520</sup>Annex V contains "Procedures for Developing Information Concerning Serious Prejudice".

<sup>521</sup>Similarly, it might be difficult to ascertain whether imports or exports are "displaced[]" or "impeded[]" under paragraphs (a) or (b) of Article 6.3 of the *SCM Agreement* without considering the effect of the challenged subsidy. By way of contrast, it might be possible to determine whether the world market share of a subsidizing Member has increased within the meaning of Article 6.3(d) before assessing whether any increase is the effect of the subsidy.

<sup>522</sup>*Supra*, para. 423.

435. Turning to the Panel's assessment of the "effect of the subsidy"<sup>529</sup>, the Panel addressed the question whether there was a "causal link"<sup>530</sup> between the price-contingent subsidies and the significant price suppression it had found. It then addressed the impact of "[o]ther alleged causal factors".<sup>531</sup> We observe that Article 6.3(c) does not use the word "cause"; rather, it states that "the effect of the subsidy is ... significant price suppression". However, the ordinary meaning of the noun "effect" is "[s]omething ... caused or produced; a result, a consequence".<sup>532</sup> The "something" in this context is significant price suppression, and thus the question is whether significant price suppression is "caused" by or is a "result" or "consequence" of the challenged subsidy. The Panel's conclusion that "[t]he text of the treaty requires the establishment of a causal link between the subsidy and the significant price suppression"<sup>533</sup> is thus consistent with this ordinary meaning of the term "effect". This is also confirmed by the context provided by Article 5(c) of the *SCM Agreement*, which provides:

No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.:

- (c) serious prejudice to the interests of another Member.

436. As the Panel pointed out, "Articles 5 and 6.3 ... do not contain the more elaborate and precise 'causation' and non-attribution language" found in the trade remedy provisions of the *SCM Agreement*.<sup>534</sup> Part V of the *SCM Agreement*, which relates to the imposition of countervailing duties, requires, *inter alia*, an examination of "any known factors other than the subsidized imports which at the same time are injuring the domestic industry".<sup>535</sup> However, such causation requirements have not been expressly prescribed for an examination of *serious prejudice* under Articles 5(c) and Article 6.3(c) in Part III of the *SCM Agreement*. This suggests that a panel has a certain degree of discretion in selecting an appropriate methodology for determining whether the "effect" of a subsidy is significant price suppression under Article 6.3(c).

<sup>529</sup>Panel Report, heading (k) to paras. 7.1334-7.1363.

<sup>530</sup>*Ibid.*, heading (i) to paras. 7.1347-7.1356.

<sup>531</sup>*Ibid.*, heading (ii) to paras. 7.1357-7.1363.

<sup>532</sup>*Shorter Oxford English Dictionary*, 5th ed., W.R. Trumble, A. Stevenson (eds.) (Oxford University Press, 2002), Vol. 1, p. 793.

<sup>533</sup>Panel Report, para. 7.1341.

<sup>534</sup>*Ibid.*, para. 7.1343.

<sup>535</sup>See Article 15.5 of the *SCM Agreement*. Article 3.5 of the *Anti-Dumping Agreement* and Article 4.2(b) of the *Agreement on Safeguards* are broadly analogous to Article 15.5 of the *SCM Agreement*.

437. Nevertheless, we agree with the Panel that it is necessary to ensure that the effects of other factors on prices are not improperly attributed to the challenged subsidies.<sup>536</sup> Pursuant to Article 6.3(c) of the *SCM Agreement*, "[s]erious prejudice in the sense of paragraph (c) of Article 5 may arise" when "the effect of the subsidy is ... significant price suppression". (emphasis added) If the significant price suppression found in the world market for upland cotton were caused by factors other than the challenged subsidies, then that price suppression would not be "the effect of" the challenged subsidies in the sense of Article 6.3(c). Therefore, we do not find fault with the Panel's approach of "examin[ing] whether or not 'the effect of the subsidy' is the significant price suppression which [it had] found to exist in the same world market"<sup>537</sup> and separately "consider[ing] the role of other alleged causal factors in the record before [it] which may affect [the] analysis of the causal link between the United States subsidies and the significant price suppression."<sup>538</sup>

438. The Panel's approach with respect to causation and non-attribution is similar to that reflected in Appellate Body decisions in the context of other WTO agreements. In connection with the *Agreement on Safeguards*, the Appellate Body has stated that a causal link "between increased imports of the product concerned and serious injury or threat thereof"<sup>539</sup> "involves a genuine and substantial relationship of cause and effect between these two elements"<sup>540</sup>, and it has also required non-attribution of effects caused by other factors.<sup>541</sup> In the context of the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* (the "*Anti-Dumping Agreement*"), the Appellate Body has stated: "[i]n order that investigating authorities, applying Article 3.5, are able to ensure that the injurious effects of the other known factors are not 'attributed' to dumped imports, they must appropriately assess the injurious effects of those other factors."<sup>542</sup> It must be borne in mind that these provisions of the *Agreement on Safeguards* and the *Anti-Dumping Agreement*, as well as the provisions of Part V of the *SCM Agreement*, relate to a determination of "injury" rather than "serious prejudice", and they apply in different contexts and with different purposes. Therefore, they must not be automatically transposed into Part III of the *SCM Agreement*. Nevertheless, they may suggest ways of assessing whether the effect of a subsidy is significant price suppression rather than it being the effect of other factors.

<sup>536</sup>Panel Report, para. 7.1344.

<sup>537</sup>*Ibid.*, para. 7.1345.

<sup>538</sup>*Ibid.*, para. 7.1346.

<sup>539</sup>Article 4.2(b) of the *Agreement on Safeguards*. Compare Article 15.5 of the *SCM Agreement* and Article 3.5 of the *Anti-Dumping Agreement*.

<sup>540</sup>Appellate Body Report, *US – Wheat Gluten*, para. 69.

<sup>541</sup>Appellate Body Report, *US – Line Pipe*, para. 208.

<sup>542</sup>Appellate Body Report, *US – Hot-Rolled Steel*, para. 223.

(e) Rationale for the Panel's Finding that the Effect of the Price-Contingent Subsidies is Significant Price Suppression

439. We now address the United States' appeal relating to the specific reasons behind the Panel's conclusion that the effect of the price-contingent subsidies is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*. The United States alleges that the Panel ignored or failed to take into account certain evidence and arguments in analyzing the effect of the price-contingent subsidies, and that the four main grounds on which the Panel based its analysis "do not withstand scrutiny".<sup>543</sup> We begin by addressing the three key elements that the United States alleges the Panel failed to include in its analysis, and then we address the reasons the Panel relied upon for its conclusion that the effect of the price-contingent subsidies is significant price suppression.

440. First, the United States contends that the Panel failed to address the relevant economic decision faced by United States upland cotton farmers at the time of planting, namely, the decision of whether to plant upland cotton or alternative crops (and how much of each). According to the United States, planted acreage of United States upland cotton responds to expected market prices at the time of harvest, rather than current prices at the time of planting.<sup>544</sup> Brazil counters that farmers decide what to plant based on expected market prices as well as expected payments under the challenged subsidy programs, such that planted acreage responds to both these factors.<sup>545</sup> Brazil also points out that farmers sell their upland cotton throughout the course of a year, at whatever prices they can obtain during the year.<sup>546</sup> During the oral hearing, the United States accepted that farmers decide what to plant based on expected market prices as well as expected subsidies.<sup>547</sup> However, according to the United States, for the 1999-2001 and 2003 crop years, when farmers made their planting decisions, the expected upland cotton price (that is, the price the farmers expected to receive upon harvest) was higher than the "income guarantee set by the marketing loan rate, suggesting that the effect of the subsidy on the planting decision was minimal".<sup>548</sup>

441. We note that the United States presented extensive evidence and arguments to the Panel in relation to expected prices and planting decisions.<sup>549</sup> Brazil also points to several questions asked by

<sup>543</sup>United States' appellant's submission, para. 180. See *supra*, para. 420.

<sup>544</sup>United States' appellant's submission, paras. 154 and 155.

<sup>545</sup>Brazil's appellee's submission, para. 692.

<sup>546</sup>Brazil's response to questioning at the oral hearing.

<sup>547</sup>See also United States' further rebuttal submission to the Panel, paras. 95-97.

<sup>548</sup>United States' statement and response to questioning at the oral hearing.

<sup>549</sup>See, for example: United States' further submission to the Panel, paras. 55-60; United States' further rebuttal submission to the Panel, paras. 95-97 and 152-177.

the Panel and responses to the Panel regarding planting decisions of United States upland cotton producers to demonstrate that the Panel was aware of the United States' arguments in this regard and took them into account.<sup>550</sup> The Panel Report makes it clear that the Panel specifically addressed "upland cotton planting decisions", "expected prices", and "expected market revenue".<sup>551</sup> The way in which United States upland cotton farmers make decisions relating to the production of upland cotton, and the basis on which they make such decisions, are factual matters that fall within the Panel's task of weighing and assessing the relevant evidence, and we will not review these matters. However, in our view, the application of the legal requirements of Article 6.3(c) to the facts determined by the Panel falls within the scope of appellate review.<sup>552</sup>

442. Turning first to Chart 2 at paragraph 7.1293 of the Panel Report, the United States submits that it is defective because it "assumes that cotton production decisions are made continuously throughout the marketing year", it "does not identify the planting decision period", and it "does not identify the expected harvest season prices at the time of that planting decision".<sup>553</sup> The Panel explained that it used this chart to demonstrate "that the per unit payment under the marketing loan programme increases when the gap between the adjusted world price and the loan rate widens"<sup>554</sup> and "that except for a short period in MY 2000, the adjusted world price was *below* the marketing loan rate throughout virtually *the whole period from MY 1999-2002*".<sup>555</sup> The Panel concluded from this graph, in connection with marketing loan program payments, that "[t]he further the adjusted world price drops, the greater the extent to which United States upland cotton producers' revenue is insulated from the decline, numbing United States production decisions from world market signals".<sup>556</sup>

443. The Panel explained how the marketing loan program payments operate and found that these payments accounted for more than half of United States upland cotton producer revenue.<sup>557</sup> This demonstrates that, in assessing the effect of marketing loan program payments under Article 6.3(c), the Panel took into account the magnitude of the payments relative to the revenue of United States

<sup>550</sup>Brazil's appellee's submission, para. 685 (referring, *inter alia*, to Brazil's response to Question 167 posed by the Panel (Panel Report, pp. 1-216-217, para.151); United States' response to Question 212 Posed by the Panel (Panel Report, p. 1-360, para. 51); Question 213 Posed by the Panel (Panel Report, p. 1-361)).

<sup>551</sup>Panel Report, para. 7.1362.

<sup>552</sup>See the discussion *supra*, para. 399.

<sup>553</sup>United States' statement at the oral hearing.

<sup>554</sup>Panel Report, para. 7.1293.

<sup>555</sup>*Ibid.*, para. 7.1294. (original emphasis)

<sup>556</sup>*Ibid.*, para. 7.1294.

<sup>557</sup>*Ibid.*, para. 7.1294.

upland cotton producers and found that marketing loan program payments made up a significant proportion of producers' revenue.<sup>558</sup>

444. During the oral hearing, the United States presented data to show that, when planting decisions were made for the 1999, 2000, 2001, and 2003 upland cotton crops, the *expected* upland cotton price upon harvest was higher than the marketing loan rate.<sup>559</sup> Accordingly, the United States contends, the marketing loan program payments would have had only a minimal effect on planting decisions, because farmers would have expected to receive a higher price from the sale of their upland cotton and no marketing loan program payments.

445. We note, based on the evidence provided by the United States, that, for four of the five upland cotton crops between 1999 and 2003, the *expected* harvest price at the time of making planting decisions was always substantially higher than the *actual* price realized at the time of harvest of the crop. This suggests that although farmers had expected higher prices in making their planting decisions, they were also aware that if actual prices were ultimately lower, they would be "insulated"<sup>560</sup> by government support, including not only marketing loan program payments but also counter-cyclical payments, which were based on a target upland cotton price of 72.4 cents per pound.<sup>561</sup> We are therefore satisfied that the Panel adopted a plausible view of the facts in connection with expected prices and planting decisions, even though it attributed to these factors a different weight or meaning than did the United States. As the Appellate Body has said, it is not necessary for panels to "accord to factual evidence of the parties the same meaning and weight as do the parties".<sup>562</sup>

446. Turning to the second key element of the United States' submission, the United States argues that the Panel ignored data showing that "U.S. cotton planted acreage did respond to expected market prices of cotton and other competing crops", "U.S. farmers change cotton acreage commensurately with changes made by cotton farmers in the rest of the world", and "the U.S. share of world cotton production has been stable, again demonstrating that U.S. farmers respond to the same market signals as cotton farmers in the rest of the world do".<sup>563</sup> The Panel Report contains several passages

<sup>558</sup>We return to the issue of quantification of the price-contingent subsidies in section VI.A.5(f) below.

<sup>559</sup>This data corresponds with the United States' written argument that "the uncontroverted evidence before the Panel ... showed that U.S. cotton plantings respond to expected prices *at the time planting decisions are taken*". (United States' appellant's submission, para. 137) (original emphasis) The United States presented similar data to the Panel. (See, for example, United States' further rebuttal submission to the Panel, paras. 162-163)

<sup>560</sup>Panel Report, para. 7.1294.

<sup>561</sup>*Ibid.*, para. 7.225.

<sup>562</sup>Appellate Body Report, *Australia – Salmon*, para. 267.

<sup>563</sup>United States' appellant's submission, para. 155.

suggesting that the Panel did take into account evidence of this kind. For example, the Panel considered the United States' evidence regarding expected upland cotton prices<sup>564</sup> and set out the United States' share of world upland cotton production during the relevant period.<sup>565</sup> It would not amount to an error in the application of Article 6.3(c) to the facts of this case for the Panel not to address specifically in its Report every item of evidence provided and to refer explicitly to every argument made by the parties, if the Panel considered certain items or arguments less significant for its reasoning than others.<sup>566</sup>

447. We now address the third key element of the United States' submission. The United States argues that "the Panel should have considered to what extent other market participants would increase supply or reduce demand in response to any alleged increase in cotton prices resulting from the absence of U.S. payments".<sup>567</sup> Brazil responds that the Panel took this factor into account because it took into account relevant aspects of certain econometric models incorporating this factor: "the models track price effects that would occur as a result of reduced U.S. upland cotton supply *and* increased supply from other countries".<sup>568</sup> The participants agree that these models incorporate the supply response of third countries.<sup>569</sup> The dispute lies in whether the Panel *took into account* supply responses of third countries, as reflected in these models or otherwise.

448. Whether and to what extent other upland cotton producers would have increased supply or reduced demand in the absence of the United States' price-contingent subsidies is ultimately an empirical inquiry. The answer to this inquiry depends on an assessment of various factors bearing on the ability of cotton producers to assess and respond to supply and demand in the world upland cotton market. We note that the Panel indicated expressly that it had taken the models in question into account.<sup>570</sup> It would have been helpful had the Panel revealed how it used these models in examining the question of third country responses. Nevertheless, we are not prepared to second-guess the Panel's

<sup>564</sup>Panel Report, para. 7.1362.

<sup>565</sup>*Ibid.*, para. 7.1282. In this paragraph, the Panel stated: "In the marketing years 1999 to 2002, the respective shares of the United States in world production of upland cotton were approximately 19.2, 19.3, 20.6 and 19.6 per cent, respectively".

<sup>566</sup>Appellate Body Report, *EC – Hormones*, paras. 135 and 138.

<sup>567</sup>United States' appellant's submission, para. 237.

<sup>568</sup>Brazil's appellee's submission, paras. 793-798 (referring to Panel Report, paras. 7.1205, 7.1209, and 7.1215) (original emphasis)

<sup>569</sup>In relation to models presented by Brazil, both parties refer to Brazil's further submission to the Panel of 9 September 2003, paras. 9-10 of Annex I (which is entitled "A Quantitative Simulation Analysis of the Impact of U.S. Cotton Subsidies on Cotton Prices and Quantities by Professor Daniel Sumner"), (United States' appellant's submission, para. 235; Brazil's appellee's submission, para. 793) In relation to third party studies, see United States' appellant's submission, para. 236 and Brazil's appellee's submission, paras. 795-796.

<sup>570</sup>Panel Report, paras. 7.1205, 7.1209 and 7.1215.

appreciation and weighing of the evidence before it, and we do not see any error on the part of the Panel in the application of the law to the facts in addressing this question.

449. We now turn to the four main grounds<sup>571</sup> on which the Panel based its conclusion that "a causal link exists between" the price-contingent subsidies and the significant price suppression it had found<sup>572</sup>, which the United States contests.<sup>573</sup> The first reason the Panel provided for finding a "causal link"<sup>574</sup> was the "substantial proportionate influence" of the United States "in the world upland cotton market ... flow[ing] ... from the magnitude of the United States production and export of upland cotton".<sup>575</sup> The United States counters that, "absent some analysis of how U.S. cotton competes with cotton from other sources, relative sizes are meaningless."<sup>576</sup> We agree that, in and of itself, the degree of influence of the United States in the world market for upland cotton may not be conclusive as to the effect of the price-contingent subsidies on prices in that market. However, if the price-contingent subsidies increased United States production and exports or decreased prices for United States upland cotton, then the fact that United States production and exports of upland cotton significantly influenced world market prices would make it more likely that the effect of the price-contingent subsidies is significant price suppression. Accordingly, this fact seems to support the Panel's conclusion, when read in conjunction with its other findings.

450. The second reason the Panel provided for finding a "causal link"<sup>577</sup> was its view that the price-contingent subsidies "are directly linked to world prices for upland cotton".<sup>578</sup> This conclusion flowed from the Panel's earlier assessment—in connection with its analysis of significant price suppression—of the *nature* of the price-contingent subsidies.<sup>579</sup> The nature of a subsidy plays an important role in any analysis of whether the effect of the subsidy is significant price suppression under Article 6.3(c). With respect to marketing loan program payments, the Panel found that "[t]he further the adjusted world price drops, the greater the extent to which United States upland cotton producers' revenue is insulated from the decline".<sup>580</sup> As a result, during the 1999-2002 marketing years, United States production and exports remained stable or increased, even though prices of

<sup>571</sup>United States' appellant's submission, para. 180.

<sup>572</sup>Panel Report, para. 7.1355.

<sup>573</sup>United States' appellant's submission, para. 180.

<sup>574</sup>Panel Report, para. 7.1347.

<sup>575</sup>*Ibid.*, para. 7.1348.

<sup>576</sup>United States' appellant's submission, para. 183.

<sup>577</sup>Panel Report, para. 7.1347.

<sup>578</sup>*Ibid.*, para. 7.1349.

<sup>579</sup>*Supra*, para. 434.

<sup>580</sup>Panel Report, para. 7.1294.

United States upland cotton decreased.<sup>581</sup> The Panel found that Step 2 payments simulate domestic and foreign demand for United States upland cotton<sup>582</sup> by "eliminating any positive difference between United States internal prices and international prices of upland cotton".<sup>583</sup> The Panel stated that Step 2 payments "result in lower world market prices than would prevail in their absence".<sup>584</sup> Finally, the Panel found that market loss assistance payments and counter-cyclical payments are made in response to low prices for upland cotton<sup>585</sup> and stimulate United States production of upland cotton by reducing the "total and per unit revenue risk associated with price variability".<sup>586</sup> The United States contends that the Panel's analysis of the price-contingent subsidies was "deficient".<sup>587</sup> However, the Panel found that the price-contingent subsidies stimulated United States production and exports of upland cotton and thereby lowered United States upland cotton prices.<sup>588</sup> This seems to us to support the Panel's conclusion that the effect of the price-contingent subsidies is significant price suppression.<sup>589</sup>

451. The third reason the Panel provided for finding a "causal link"<sup>590</sup> was that "there is a discernible temporal coincidence of suppressed world market prices" and the price-contingent subsidies.<sup>591</sup> The United States describes this as "an exercise in spurious correlation".<sup>592</sup> However, in our view, one would normally expect a discernible correlation between significantly suppressed prices and the challenged subsidies if the effect of these subsidies is significant price suppression. Accordingly, this is an important factor in any analysis of whether the effect of a subsidy is significant price suppression within the meaning of Article 6.3(c). However, we recognize that mere correlation between payment of subsidies and significantly suppressed prices would be insufficient, without more, to prove that the effect of the subsidies is significant price suppression.

<sup>581</sup>Panel Report, para. 7.1296.

<sup>582</sup>*Ibid.*, para. 7.1299.

<sup>583</sup>*Ibid.*, para. 7.1298.

<sup>584</sup>*Ibid.*, para. 7.1299.

<sup>585</sup>*Ibid.*, para. 7.1301.

<sup>586</sup>*Ibid.*, para. 7.1302 and footnote 1410 to para. 7.1302.

<sup>587</sup>United States' appellant's submission, para. 185.

<sup>588</sup>Panel Report, para. 7.1291, 7.1295-7.1296, 7.1299, and 7.1308-7.1311.

<sup>589</sup>We do not exclude the possibility that challenged subsidies that are not "price-contingent" (to use the Panel's term) could have some effect on production and exports and contribute to price suppression.

<sup>590</sup>Panel Report, para. 7.1347.

<sup>591</sup>*Ibid.*, para. 7.1351.

<sup>592</sup>United States' appellant's submission, para. 208.

452. The fourth reason the Panel provided for finding a "causal link"<sup>593</sup> was the "divergence between United States producers' total costs of production and revenue from sales of upland cotton since 1997".<sup>594</sup> The United States argues that the Panel should have examined variable rather than total costs<sup>595</sup> in assessing whether "United States upland cotton producers would ... have been economically capable of remaining in the production of upland cotton had it not been for the United States subsidies at issue".<sup>596</sup>

453. We agree with the general proposition of the United States that variable costs may play a role in farmers' decision-making as to whether to plant upland cotton or some alternative crop, and how much of each crop to plant. From a short-term perspective, variable costs may be particularly important. However, from a longer-term perspective, total costs may be relevant. Based on the evidence before it regarding upland cotton production in the United States, the Panel concluded that "the six-year period from 1997-2002 ... lends itself to an assessment of the medium- to longer-term examination of developments in the United States upland cotton industry".<sup>597</sup> The Panel found that "the effect of the subsidies was to allow United States producers to sell upland cotton at a price lower than would otherwise have been necessary to cover their total costs".<sup>598</sup> In the circumstances of this dispute, we do not consider that the Panel's reliance on total rather than variable costs of production amounts to an error vitiating the Panel's analysis under Article 6.3(c).

454. Finally, we consider the "other causal factors alleged by the United States"<sup>599</sup> to have had an effect on prices. The United States argues that the Panel erred in addressing upland cotton planting decisions as an "other causal factor", given that the United States maintained that the price-contingent subsidies did not cause price suppression at all.<sup>600</sup> We disagree. We have already addressed the United States' arguments with respect to planting decisions, and we find no fault in the Panel's consideration of the issue of "planting decisions".<sup>601</sup>

<sup>593</sup>Panel Report, para. 7.1347.

<sup>594</sup>*Ibid.*, para. 7.1353. (footnote omitted)

<sup>595</sup>United States' appellant's submission, para. 215.

<sup>596</sup>Panel Report, para. 7.1353.

<sup>597</sup>*Ibid.*, para. 7.1354.

<sup>598</sup>*Ibid.*, para. 7.1353.

<sup>599</sup>*Ibid.*, para. 7.1357.

<sup>600</sup>United States' appellant's submission, para. 138.

<sup>601</sup>*Supra*, paras. 440-445.

455. The United States also argues that United States upland cotton exports increased during 1998-2002<sup>602</sup> because textile imports increased in the same period, leading to a decline in the use of cotton by domestic mills.<sup>603</sup> The Panel regarded this factor as "concerning support, rather than suppression, of world cotton prices".<sup>604</sup> However, even assuming that increasing textile imports led to increased exports of upland cotton, this does not mean that the price-contingent subsidies did not have the effect of significant price suppression. It was not unreasonable for the Panel to conclude that the "effect" of the price-contingent subsidies was significant price suppression, even if some other factor might also have price-suppressive effects.<sup>605</sup>

456. The remaining three "other causal factors" that the Panel examined were weakness in world demand for upland cotton, the strong United States dollar, and the release by China of government upland cotton stocks between 1999 and 2001.<sup>606</sup> The United States does not specifically address these three factors in its appellant's submission. However, the Panel's discussion of these "other factors" was part of the reasoning leading to the Panel's conclusion under Article 6.3(c), which the United States does appeal.<sup>607</sup> The Panel found that the United States' argument that weak demand caused low prices was inconsistent with the increase in United States upland cotton production and the absence of "pronounced declines" in world upland cotton consumption.<sup>608</sup> With regard to the United States dollar, the Panel stated that exchange rates would affect market prices, but that market prices did not guide "United States producer decisions (except to the extent that, when they are lower than the marketing loan rate, they dictate the magnitude of United States government subsidies to producers)".<sup>609</sup> The Panel pointed to evidence on the record confirming that marketing loan program payments and Step 2 payments "offset" declines in market prices.<sup>610</sup> With respect to upland cotton stocks released by China, the Panel agreed with the United States (and Brazil) that "an infusion of a large amount of supply onto the market would exert a downward pressure on prices".<sup>611</sup> However, the

<sup>602</sup>The United States also argues that 1998 was an inappropriate base year for the Panel's examination because of unusually weak world demand and reduced United States production due to drought. (United States' appellant's submission, para. 209)

<sup>603</sup>United States' appellant's submission, para. 211.

<sup>604</sup>Panel Report, para. 7.1359.

<sup>605</sup>In this regard, see *supra*, para. 437 and *infra*, para. 457.

<sup>606</sup>Panel Report, paras. 7.1358, 7.1360, and 7.1361.

<sup>607</sup>In appealing this finding, the United States refers in a footnote to paras. 7.1107-7.1416 and 8.1(g)(i) of the Panel Report. (United States' appellant's submission, footnote 531 to para. 516(8))

<sup>608</sup>Panel Report, para. 7.1358.

<sup>609</sup>*Ibid.*, para. 7.1360.

<sup>610</sup>*Ibid.*, footnote 1477 to para. 7.1360.

<sup>611</sup>*Ibid.*, para. 7.1361.

Panel pointed out that the stock released by the Chinese government "was smaller in magnitude than the United States exports over this period".<sup>612</sup>

457. The Panel concluded:

Although some of these factors may have contributed to lower, and even suppressed, world upland cotton prices during MY 1999-2002, they do not attenuate the genuine and substantial causal link that we have found between the United States mandatory price-contingent subsidies at issue and the significant price suppression. Nor do they reduce the effect of the mandatory price-contingent subsidies to a level which cannot be considered "significant".<sup>613</sup>

In sum, the Panel Report shows that it examined the other factors raised by the United States. Although the Panel found that some of them had price-suppressive effects, it did not attribute those effects to the United States' price-contingent subsidies.

458. Unlike in certain other instances under the WTO agreements, a panel conducting an analysis under Article 6.3(c) of the *SCM Agreement* is the first trier of facts, rather than a reviewer of factual determinations made by a domestic investigating authority. Bearing this in mind, we underline the responsibility of panels in gathering and analyzing relevant factual data and information in assessing claims under Article 6.3(c) in order to arrive at reasoned conclusions. In this case, the voluminous evidentiary record before the Panel included several economic studies, and substantial data and information. For its part, the Panel posed a large number of questions to which the parties submitted detailed answers. Overall, the Panel evidently conducted an extensive analysis, but we believe that, in its reasoning, the Panel could have provided a more detailed explanation of its analysis of the complex facts and economic arguments arising in this dispute. The Panel could have done so in order to demonstrate precisely how it evaluated the different factors bearing on the relationship between the price-contingent subsidies and significant price suppression. Nevertheless, in the light of the Panel's examination of the relevant evidence, coupled with its legal reasoning, we find no legal error in the Panel's causation analysis.

(f) Amount of the Price-Contingent Subsidies

459. In reaching the conclusion that the effect of the price-contingent subsidies is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*, the Panel made the following statements with respect to the amount of the price-contingent subsidies as a whole:

We have readily available information on the record showing us that the price-contingent subsidies in question involve very large amounts of United States government money benefiting United States upland cotton.<sup>614</sup>

[W]hile we do not believe that it is strictly necessary[ly] to calculate precisely the amount of the subsidies in question, we observe that we have readily available information on the record showing us that the price-contingent subsidies in question involve very large amounts of United States government money benefiting United States upland cotton production.<sup>615</sup>

In addition, the Panel made statements regarding the amount of individual price-contingent subsidies, namely marketing loan program payments and Step 2 payments.<sup>616</sup>

460. On appeal, the United States raises several points. First, the United States argues that the Panel was required to quantify the amount of the price-contingent subsidies benefiting upland cotton.<sup>617</sup> Secondly, the United States submits that counter-cyclical and market loss assistance payments to recipients who did not produce upland cotton did not benefit upland cotton at all and therefore could not have caused serious prejudice.<sup>618</sup> As for counter-cyclical and market loss assistance payments to recipients who produced both upland cotton and other products, the Panel should have "allocated [the subsidies] over the total sales of the recipients".<sup>619</sup> Thirdly, the United States maintains that the Panel erred, in its Article 6.3(c) analysis, by failing to identify the amount of benefit flowing to processed cotton from price-contingent subsidies paid to producers of raw cotton.<sup>620</sup>

461. Beginning with the text of Article 6.3(c), we note that this provision does not state explicitly that a panel needs to quantify the amount of the challenged subsidy. However, in assessing whether "the effect of the subsidy is ... significant price suppression", and ultimately serious prejudice, a panel

<sup>614</sup>Panel Report, para. 7.1308.

<sup>615</sup>*Ibid.*, para. 7.1349.

<sup>616</sup>"While we do not believe it is necessary to calculate the precise amount of the subsidies in question, we observe that we have this information readily available on the record. This is a very large amount". (Panel Report, paras. 7.1297 and 7.1300) (footnote omitted)

<sup>617</sup>United States' appellant's submission, para. 240. The United States does not contest the Panel's view that, in assessing the price-contingent subsidies under Article 6.3(c), it was not required to quantify *precisely* the amount of the subsidies benefiting upland cotton. (See United States' appellant's submission, para. 258; Panel Report, paras. 7.1173, 7.1186 and 7.1226) The United States clarified this point in response to questioning during the oral hearing.

<sup>618</sup>United States' appellant's submission, para. 242.

<sup>619</sup>*Ibid.*, para. 264.

<sup>620</sup>*Ibid.*, para. 301 and footnote 314 to para. 301. In response to questioning during the oral hearing, the United States confirmed that its appeal regarding "raw" and "processed" cotton relates to all the price-contingent subsidies.

will need to consider the effects of the subsidy on prices. The magnitude of the subsidy is an important factor in this analysis.<sup>621</sup> A large subsidy that is closely linked to prices of the relevant product is likely to have a greater impact on prices than a small subsidy that is less closely linked to prices. All other things being equal, the smaller the subsidy for a given product, the smaller the degree to which it will affect the costs or revenue of the recipient, and the smaller its likely impact on the prices charged by the recipient for the product. However, the size of a subsidy is only one of the factors that may be relevant to the determination of the effects of a challenged subsidy. A panel needs to assess the effect of the subsidy taking into account all relevant factors.

462. In order for a panel to find that a subsidy has the effect of significant price suppression, or some other effect mentioned in Article 6.3(c), the panel must determine that the payment is a specific subsidy within the meaning of Articles 1 and 2 of the *SCM Agreement*.<sup>622</sup> The Panel did so in this dispute<sup>623</sup>, and we do not understand the United States to contest this conclusion. Rather, the United States argues that a panel needs to quantify the amount of the "benefit" conferred on the subsidized product by a challenged subsidy.<sup>624</sup> However, the definitions of a specific subsidy in Articles 1 and 2 do not expressly require the quantification of the "benefit" conferred by the subsidy on any particular product.

463. Turning to the context of Article 6.3(c), we note that Article 6.1(a)—which has now expired—contains the only reference in Part III of the *SCM Agreement* to a calculation of *ad valorem* subsidization of a product. Footnote 14 to Article 6.1(a) explains that this calculation is to be performed in accordance with Annex IV on the "Calculation of the Total Ad Valorem Subsidization (Paragraph 1(a) of Article 6)". No similar provisions are found in Article 6.3(c), which suggests that no precise quantification is envisaged in that provision.

464. The United States does not argue, as a general matter, that the methodologies in Part V of the *SCM Agreement* apply directly to a serious prejudice analysis under Part III of the *SCM Agreement*.<sup>625</sup> However, the United States identifies Part V as providing relevant context for the

<sup>621</sup> *Supra*, para. 432.

<sup>622</sup> As the United States points out, the word "subsidy" in Article 6.3(c) is defined in Article 1.1 of the *SCM Agreement*, and the subsidies subject to the disciplines in Part III of the *SCM Agreement* (including Articles 5(c) and 6.3(c)) must be "specific" pursuant to Article 1.2. A "subsidy" as defined in the *SCM Agreement* involves the conferral of a "benefit" under Article 1.1(b). (See United States' appellant's submission, paras. 244 and 245)

<sup>623</sup> Panel Report, paras. 7.1120 and 7.1154.

<sup>624</sup> United States' appellant's submission, para. 246.

<sup>625</sup> *Ibid.*, para. 258, as confirmed during the oral hearing.

interpretation of Articles 5(c) and 6.3(c) of the *SCM Agreement*.<sup>626</sup> We note that the apparent rationale for Part III differs from that for Part V of the *SCM Agreement*. Under Part V, the amount of the subsidy must be calculated because, under Article 19.4 of the *SCM Agreement* and Article VI:3 of the GATT 1994, countervailing duties cannot be levied in excess of that amount. In contrast, under Part III, the remedy envisaged under Article 7.8 of the *SCM Agreement* is the withdrawal of the subsidy or the removal of the adverse effects. This remedy is not specific to individual companies. Rather, it targets the effects of the subsidy more generally. Article 6.3(c) thus goes in the same vein and does not require a precise quantification of the subsidies at issue.

465. The provisions of the *SCM Agreement* regarding quantification of subsidies reveal that the methodological approaches to quantification may be quite different, depending on the context and purpose of quantification.<sup>627</sup> The absence of any indication in Article 6.3(c) as to whether one of these methods, or any other method, should be used suggests to us that no such precise quantification was envisaged as a necessary prerequisite for a panel's analysis under Article 6.3(c).

466. Pursuant to Article 6.8, "the existence of serious prejudice" under Article 6.3(c) "should be determined on the basis of the information submitted to or obtained by the panel, including information submitted in accordance with the provisions of Annex V" of the *SCM Agreement*. The United States is correct that Annex V refers to "information ... as necessary to establish the existence and amount of subsidization" (in paragraph 2) and "data concerning the amount of the subsidy in question" (in paragraph 5)<sup>628</sup>, but Annex V also refers to other information.<sup>629</sup> This demonstrates that the amount of the subsidy, as well as other elements, are relevant for the assessment of whether price suppression exists. But we do not read Annex V as mandating the precise quantification of subsidies in order to determine their effect under Article 6.3(c).

467. In sum, reading Article 6.3(c) in the context of Article 6.8 and Annex V suggests that a panel should have regard to the magnitude of the challenged subsidy and its relationship to prices of the product in the relevant market when analyzing whether the effect of a subsidy is significant price

<sup>626</sup> United States' appellant's submission, para. 260.

<sup>627</sup> In relation to countervailing duties, Article 19.4 of the *SCM Agreement* specifies that the amount of the subsidy is to be "calculated in terms of subsidization per unit of the subsidized and exported product". Article 14 of the *SCM Agreement* adds that this calculation is to be done "in terms of the benefit to the recipient". In contrast, under Article 6.1(a) and paragraph 1 of Annex IV of the *SCM Agreement*, which relate to a claim of serious prejudice as mentioned above, the "total ad valorem subsidization of a product" is to be calculated "in terms of the cost to the granting government". (footnote omitted)

<sup>628</sup> United States' appellant's submission, paras. 247-252.

<sup>629</sup> For example, paragraph 3 of Annex V refers to information such as "customs data concerning imports and declared values of the products concerned". Paragraph 5 of Annex V refers to information such as "prices of the subsidized product, prices of the non-subsidized product, prices of other suppliers to the market, changes in the supply of the subsidized product to the market in question and changes in market shares".

suppression. In many cases, it may be difficult to decide this question in the absence of such an assessment. Nevertheless, this does not mean that Article 6.3(c) imposes an obligation on panels to quantify precisely the amount of a subsidy benefiting the product at issue in every case. A precise, definitive quantification of the subsidy is not required.

468. In the present case, the Panel could have been more explicit and specified what it meant by "very large amounts"<sup>630</sup>, beyond including cross-references to its earlier findings regarding certain subsidies. Nevertheless, the information before the Panel clearly supports the Panel's general statements regarding the magnitude of the price-contingent subsidies.<sup>631</sup>

469. In addition to its arguments regarding quantification, the United States contends that the Panel should have used an allocation methodology to determine the amount of "decoupled" market loss assistance payments and counter-cyclical payments that benefits a given product. It argues that Annex IV of the *SCM Agreement* contains an "economically neutral"<sup>632</sup> allocation methodology agreed by WTO Members, pursuant to which "the subsidy would be allocated to the product according to the ratio of sales of that product to the total value of the recipient firm's sales."<sup>633</sup> It is clear that use of the Annex IV methodology is not expressly *required* by Article 6.3(c). We also observe that the Panel described as "appropriate"<sup>634</sup> certain alternative allocation methodologies to the one it relied upon that sought to reduce the amount of payments with respect to upland cotton base acres within the base acre dependent programs to account only for payments corresponding to acres that were actually planted with upland cotton.<sup>635</sup> In our view, even using these alternative allocation methodologies for market loss assistance payments and counter-cyclical payments, the Panel's conclusion regarding the order of magnitude of the price-contingent subsidies stands.<sup>636</sup>

470. Finally, we address the related United States argument that the Panel failed to determine the extent to which the "benefit" of price-contingent subsidies paid to producers of "raw" cotton flowed through to "processed" cotton. We note that the Panel seemed to regard market loss assistance payments and counter-cyclical payments as benefiting the production of upland cotton lint.<sup>637</sup> As for

<sup>630</sup>*Supra*, para. 459.

<sup>631</sup>Panel Report, paras. 7.596 and 7.641; United States' response to questions posed by the Panel (Panel Report, p. I-126, para. 211).

<sup>632</sup>United States' appellant's submission, para. 269.

<sup>633</sup>*Ibid.*, para. 268.

<sup>634</sup>Panel Report, para. 7.646.

<sup>635</sup>*Ibid.*, "Attachment to Section VII.D", paras. 7.634-7.647.

<sup>636</sup>Table 3 of Annex 2.

<sup>637</sup>Panel Report, para. 7.1226 and footnote 258 to para. 7.197. See *supra*, para. 407 and footnote 451.

marketing loan program payments and Step 2 payments, the Panel suggested that it is a condition of eligibility for these payments that harvested cotton containing cotton lint and cottonseed "be 'baled' and/or 'ginned'".<sup>638</sup>

471. The United States contends that the Appellate Body's reasoning in *US – Softwood Lumber IV* indicates that it cannot be presumed that a "subsidy", as defined in Article 1.1 of the *SCM Agreement*, provided to a producer of an input (such as raw cotton) "passes through" to the producer of the processed product (in this case, upland cotton lint).<sup>639</sup> However, the Appellate Body's reasoning in that dispute focuses not on the requirements for establishing serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*, but on the conduct of countervailing duty investigations pursuant to Part V of the *SCM Agreement*.<sup>640</sup>

472. As we have already noted<sup>641</sup>, the requirement in Article VI.3 of the GATT 1994 and Article 19.4 of the *SCM Agreement* that countervailing duties on a product be limited to the amount of the subsidy accruing to that product finds no parallel in the provisions on actionable subsidies and pertinent remedies under Part III of the *SCM Agreement*. Therefore, the need for a "pass-through" analysis under Part V of the *SCM Agreement* is not critical for an assessment of significant price suppression under Article 6.3(c) in Part III of the *SCM Agreement*. Nevertheless, we acknowledge that the "subsidized product" must be properly identified for purposes of significant price suppression under Article 6.3(c) of the *SCM Agreement*. And if the challenged payments do not, in fact, subsidize that product, this may undermine the conclusion that the effect of the subsidy is significant suppression of prices of that product in the relevant market.

473. For these reasons, we find that the Panel did not err in its assessment of the amount of the subsidies for the purpose of its analysis under Article 6.3(c) of the *SCM Agreement*.

<sup>638</sup>Panel Report, footnote 258 to para. 7.197. See also *ibid.*, footnotes 1339 and 1340 to para. 7.1225.

<sup>639</sup>United States' appellant's submission, paras. 304 and 305 (quoting Appellate Body Report, *US – Softwood Lumber IV*, para. 142).

<sup>640</sup>Appellate Body Report, *US – Softwood Lumber IV*, paras. 140-142. The Appellate Body there addressed the need for authorities to ensure that the subsidy at issue confers a benefit on the product against which countervailing duties are to be imposed (pursuant to Article 1.1 of the *SCM Agreement*) and that those duties do not exceed the total amount of the subsidy accruing to that product (pursuant to Article VI.3 of the GATT 1994). The facts in that case are also quite different from those in the present dispute. In *US – Softwood Lumber IV*, it was undisputed that lumber is a distinct product from trees or logs, and countervailing duties were imposed on exported lumber and not on trees or logs. (Appellate Body Report, *US – Softwood Lumber IV*, para. 124) In contrast, in the present dispute, no such clear distinction exists between cotton lint and "raw cotton", meaning (presumably) harvested cotton containing cottonseed and cotton lint.

<sup>641</sup>*Supra*, para. 464.

## (g) Effect of the Price-Contingent Subsidies Over Time

474. The United States asserts that the Panel erred in making serious prejudice findings with respect to the price-contingent subsidies provided in marketing years 1999 to 2001.<sup>642</sup> According to the United States, a "recurring" subsidy payment does not confer a benefit after the year for which it is paid, and therefore it is no longer a "subsidy" under Article 1 of the *SCM Agreement*. A subsidy that is paid annually must be "allocated" or "expensed"<sup>643</sup> to the year "for which the payment is made"<sup>644</sup>, and the effect of such a payment cannot be "significant price suppression" in any other year. The price-contingent subsidies "are made annually with respect to a particular marketing year"<sup>645</sup>, and therefore the effect of those subsidies cannot extend to any later marketing year. In any case, the United States argues that the Panel did not find that these subsidy payments had "continuing effects".<sup>646</sup> The Panel was established in marketing year 2002<sup>647</sup> and, therefore, the Panel could not have found that the effect of the price-contingent subsidies for marketing years 1999 to 2001 is significant price suppression.<sup>648</sup>

475. We observe that the United States' contention that the effect of a subsidy must be "allocated" or "expensed" to the year in which it is paid is confined to "recurring" subsidies, that is, subsidies paid on an annual basis. The United States acknowledges that "non-recurring" subsidies could be "allocated" to subsequent years as well. Article 6.3(c) of the *SCM Agreement* applies to a subsidy whether it is "recurring" or "non-recurring". This Article does not suggest that the effect of a subsidy is limited to or continues only for a specified period of time.

476. In this appeal, we are asked to address the limited question of whether the effect of a subsidy may continue beyond the year in which it was paid, in the context of a significant price suppression analysis under Article 6.3(c) of the *SCM Agreement*. Whether the effect of a subsidy begins and

<sup>642</sup>See *supra*, para. 422(c). "Because the recurring subsidies provided in each of marketing years 1999, 2000, and 2001 ceased to exist when the benefit was used up for production in those years, the effect of those subsidies cannot be the subject of subsidies claims in marketing year 2002." (United States' appellant's submission, para. 284)

<sup>643</sup>United States' appellant's submission, para. 284.

<sup>644</sup>The United States argues that "recurring" subsidies should be "allocated ... to the marketing year to which they relate". (United States' appellant's submission, para. 275) In response to questioning during the oral hearing, the United States clarified that when it refers to the year to which a subsidy *relates* it means "the year for which the payment is made".

<sup>645</sup>United States' appellant's submission, para. 291.

<sup>646</sup>*Ibid.*, para. 278.

<sup>647</sup>The DSB established the Panel on 18 March 2003. (WT/DS267/15; Panel Report, para. 1.2) "The date on which the Panel was established fell during the 2002 marketing year for upland cotton in the United States, which began on 1 August 2002 and ended on 31 July 2003." (Panel Report, para. 7.185)

<sup>648</sup>United States' appellant's submission, para. 278.

expires in the year in which it is paid or begins in one year and continues in any subsequent year, and how long a subsidy can be regarded as having effects, are fact-specific questions. The answers to these questions may depend on the nature of the subsidy and the product in question. We see nothing in the text of Article 6.3(c) that excludes *a priori* the possibility that the effect of a "recurring" subsidy may continue after the year in which it is paid. Article 6.3(c) deals with the "effect" of a subsidy, and not with the financial accounting of the amount of the subsidy.<sup>649</sup>

477. The context of Article 6.3(c) within Part III of the *SCM Agreement* does not support the suggestion that the effect of a subsidy is immediate, short-lived, or limited to one year, regardless of whether or not it is paid every year. Article 6.2 of the *SCM Agreement* refers to the possibility of the subsidizing Member demonstrating that "the subsidy in question *has not resulted* in any of the effects enumerated in paragraph 3".<sup>650</sup> (emphasis added) The word "resulted" in this sentence highlights the temporal relationship between the subsidy and the effect, in that one might expect a time lag between the provision of the subsidy and the resulting effect.<sup>651</sup> In addition, the use of the present perfect tense in this provision implies that some time may have passed between the granting of the subsidy and the demonstration of the absence of its effects.<sup>652</sup>

478. Article 6.4 of the *SCM Agreement* is also relevant context for interpreting Article 6.3(c). Article 6.4 requires that the displacement or impeding of exports be demonstrated "over an appropriately representative period", which "shall be at least one year", so that "clear trends" in changes in market share can be demonstrated.<sup>653</sup> This suggests that the effect of a subsidy under Article 6.4 must be examined over a sufficiently long period of time and is not limited to the year in which it was paid. As the Panel has also pointed out in the context of Article 6.3(c), "[c]onsideration

<sup>649</sup>Although the accounting treatment of a subsidy may be relevant, it does not control the assessment of the effect of the subsidy under Article 6.3(c).

<sup>650</sup>The French version of Article 6.2 states that "la subvention ... n'a eu aucun des effets énumérés au paragraphe 3". The Spanish version of Article 6.2 states "la subvención en cuestión no ha producido ninguno de los efectos enumerados en el párrafo 3".

<sup>651</sup>The Spanish version of Article 6.2 uses the word "producido" for "resulted", again suggesting a time lag between the provision of the subsidy and the resulting effect. The French version of Article 6.2 uses a more neutral term, "eu", which includes but perhaps does not emphasize this temporal connotation as strongly. See *supra*, footnote 650.

<sup>652</sup>The French and Spanish versions of Article 6.2 also use the present perfect tense. See *supra*, footnote 650.

<sup>653</sup>Article 6.4 reads in relevant part:

[T]he displacement or impeding of exports shall include any case in which ... it has been demonstrated that there has been a *change* in relative shares of the market to the disadvantage of the non-subsidized like product (*over an appropriately representative period* sufficient to demonstrate clear *trends* in the development in the market for the product concerned, which, in normal circumstances, shall be *at least one year*). ... (emphasis added)

of developments over a period of longer than one year ... provides a more robust basis for a serious prejudice evaluation than merely paying attention to developments in a single recent year".<sup>654</sup>

479. The United States supports its arguments regarding the "allocation" of "recurring" and "non-recurring" subsidies by referring to several sources.<sup>655</sup> The United States submits that "the Appellate Body has acknowledged that 'non-recurring' subsidies may be allocated over time"<sup>656</sup>, citing the following statement of the Appellate Body in *US – Lead and Bismuth II*:

[W]e agree with the Panel that while an investigating authority may presume, in the context of an administrative review under Article 21.2, that a "benefit" continues to flow from an untied, non-recurring "financial contribution", this presumption can never be "irrebuttable".<sup>657</sup>

In our view, this statement does not support the United States' argument. A proper reading of this statement reveals that it was made in the context of Part V of the *SCM Agreement*, and it focuses on the *benefit* flowing from a "non-recurring" financial contribution rather than the *effect* of a subsidy. Indeed, the Appellate Body's conclusion that investigating authorities cannot adopt an irrebuttable presumption that a benefit continues to flow from certain non-recurring financial contributions highlights the importance of examining the particular characteristics of a given subsidy in evaluating its impact.

480. In addition, the United States refers to paragraph 7 of Annex IV to the *SCM Agreement*<sup>658</sup>, which provides that "[s]ubsidies granted prior to the entry into force of the WTO Agreement, the benefits of which are allocated to future production, shall be included in the overall rate of subsidization." Although this provision recognizes that the benefits of some subsidies may be allocated to future production, it does not specify that this applies exclusively to "non-recurring"

<sup>654</sup>Panel Report, para. 7.1199.

<sup>655</sup>United States' appellant's submission, paras. 282 and 283, citing: *SCM Agreement*, paragraph 7 of Annex IV; Guidelines on Amortization and Depreciation adopted by the Tokyo Round Committee on Subsidies and Countervailing Measures, SCM/64, BISD 32S/154 (25 April 1985), para. 1; *Anti-Dumping Agreement*, Article 2.2.1.1; Appellate Body Report, *US – Lead and Bismuth II*, para. 62; Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing Measures, G/SCM/W/415/Rev.2 (15 May 1998), Recommendation I and paras. 1-12.

<sup>656</sup>United States' appellant's submission, para. 283.

<sup>657</sup>Appellate Body Report, *US – Lead and Bismuth II*, para. 62.

<sup>658</sup>The title of Annex IV of the *SCM Agreement* is "Calculation of the Total Ad Valorem Subsidization (Paragraph 1(a) of Article 6)". (footnote omitted)

subsidies. In any event, as the Panel noted, the "effect" of a subsidy cannot be equated with the "benefit" of a subsidy.<sup>659</sup>

481. The United States also points to Article 2.2.1.1 of the *Anti-Dumping Agreement*, which relates to the calculation of costs in constructing a normal value under Article 2.2, in order to calculate a dumping margin in certain circumstances. Article 2.2.1.1 states, in relevant part, that "costs shall be adjusted appropriately for those non-recurring items of cost which benefit future and/or current production". However, this provision pertains to the method of calculation of producers' costs in constructing the normal value of a product, which is a different inquiry. It does not apply in assessing the effect of a subsidy under Article 6.3(c) of the *SCM Agreement*.

482. For these reasons, we are not persuaded by the United States' contention that the effect of annually paid subsidies must be "allocated" or "expensed" solely to the year in which they are paid and that, therefore, the effect of such subsidies cannot be significant price suppression in any subsequent year. We do not agree with the proposition that, if subsidies are paid annually, their effects are also necessarily extinguished annually.

483. Turning to the effect of the subsidies at issue in this appeal, we note that the Panel found that the effect of the price-contingent subsidies for marketing years 1999 to 2002<sup>660</sup> "is significant price suppression ... in the period MY 1999-2002".<sup>661</sup> The Panel did not specify which subsidies had effects in which years; nor did it specifically state that the effect of the subsidies for marketing years 1999-2001 was significant price suppression in marketing year 2002. This is consistent with the Panel's earlier statement regarding the way in which it would conduct its analysis:

[I]n our price suppression analysis under Article 6.3(c), we examine one effects-related variable – prices – and one subsidized product – upland cotton. To the extent a sufficient nexus with these exists among the subsidies at issue so that their effects manifest themselves collectively, we believe that we may legitimately treat them as a "subsidy" and group them and their effects together.<sup>662</sup>

484. For this reason, the Panel examined the price-contingent subsidies for marketing years 1999 to 2002 as a group<sup>663</sup>, and its finding of significant price suppression in marketing years 1999 to

<sup>659</sup>Panel Report, para. 7.1179.

<sup>660</sup>*Ibid.*, para. 7.1108.

<sup>661</sup>*Ibid.*, para. 7.1416. Before the Panel, Brazil also claimed that United States subsidies to be granted from marketing year 2003 to marketing year 2007 threaten to cause serious prejudice to Brazil's interests. (*Ibid.*, para. 7.1478) However, the payments to be made in marketing years 2003-2007 and the issue of *threat* of serious prejudice under the *SCM Agreement* do not form part of this appeal.

<sup>662</sup>*Ibid.*, para. 7.1192.

<sup>663</sup>Panel Report, para. 7.1290.

2002<sup>664</sup> applied to this group of subsidies. As we noted above, the effects of a "recurring" subsidy may continue after the year in which it is paid.<sup>665</sup> Given that the Panel found significant price suppression in the period 1999 to 2002 as a whole, and this period includes the marketing year 2002, we are unable to agree with the United States' assertion that the Panel erred in not making a specific finding that the price-contingent subsidies for marketing years 1999 to 2001 "had continuing effects at the time of panel establishment".<sup>666</sup>

6. Serious Prejudice under Article 5(c) of the SCM Agreement

485. Having found that the effect of the price-contingent subsidies is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*<sup>667</sup>, the Panel then considered whether the United States had caused adverse effects in the form of serious prejudice to the interests of Brazil through the use of these subsidies, contrary to Article 5(c) of the *SCM Agreement*. The Panel found that the significant price suppression it had found under Article 6.3(c) of the *SCM Agreement* amounted to serious prejudice within the meaning of the Article 5(c) of the *SCM Agreement*<sup>668</sup>, based on the following findings:

[A]n affirmative conclusion that the effects-based situation in Article 6.3(c) exists is a sufficient basis for an affirmative conclusion that "serious prejudice" exists for the purposes of Article 5(c) of the *SCM Agreement*.<sup>669</sup>

[A]ssuming *arguendo* that any sort of additional demonstration is necessary to establish that the "significant price suppression" we have found to exist in the same world market constitutes prejudice amounting to "serious prejudice" within the meaning of Article 5(c), ... Brazil has also fulfilled that burden.<sup>670</sup>

486. Thus, the Panel provided two alternative reasons for finding that the significant price suppression it had found amounted to serious prejudice within the meaning of the Article 5(c) of the *SCM Agreement*.<sup>671</sup> The Panel's primary reason was that if the effect of a subsidy is significant price suppression within the meaning of Article 6.3(c), this is sufficient, without more, to conclude that the

<sup>664</sup>*Ibid.*, para. 7.1416.

<sup>665</sup>*Supra*, para. 482.

<sup>666</sup>United States' appellant's submission, para. 278.

<sup>667</sup>Panel Report, paras. 7.1355-7.1356 and 7.1363.

<sup>668</sup>*Ibid.*, paras. 7.1395 and 8.1(g)(i).

<sup>669</sup>*Ibid.*, para. 7.1390.

<sup>670</sup>*Ibid.*, para. 7.1391.

<sup>671</sup>Panel Report, paras. 7.1395 and 8.1(g)(i).

subsidizing Member has caused serious prejudice to the interests of another Member within the meaning of Article 5(c).<sup>672</sup> The Panel's alternative reason was that, even if this is not sufficient, Brazil had fulfilled the burden of demonstrating that the United States had caused serious prejudice to the interests of Brazil within the meaning of Article 5(c).<sup>673</sup>

487. In its Notice of Appeal, and in the "Conclusion" section of its Appellant's Submission, the United States challenged the Panel's finding "that 'significant price suppression' is sufficient to establish 'serious prejudice' for purposes of Articles 5(c) and 6.3 of the SCM Agreement".<sup>674</sup> Brazil asks us to dismiss this claim because the United States did "not appear to have advanced arguments in its Appellant's Submission" in relation to it.<sup>675</sup> In response to questioning during the oral hearing, the United States clarified that, in its Notice of Appeal, it intended to challenge only the first of the two findings mentioned above (that is, the Panel's finding in paragraph 7.1390 of the Panel Report). However, the United States indicated that it did not pursue this claim in its appellant's submission.

488. As neither party has appealed the Panel's finding in paragraph 7.1390 of the Panel Report (regarding the sufficiency of a finding of an effect under Article 6.3(c) for a finding of serious prejudice under Article 5(c), in general terms) or the Panel's alternative finding in paragraph 7.1391 of the Panel Report (regarding serious prejudice to the interests of Brazil in the particular circumstances of this dispute), we express no opinion on either of those findings. Nor do we address the Panel's consequential finding that the significant price suppression that it had found to be the effect of the price-contingent subsidies under Article 6.3(c) of the *SCM Agreement* amounted to serious prejudice within the meaning of Article 5(c) of the *SCM Agreement*.<sup>676</sup> Accordingly, upon adoption of the Panel Report by the DSB, the Panel's findings in paragraphs 7.1390 and 7.1391 of the Panel Report as mentioned above<sup>677</sup> would stand, without endorsement or rejection by the Appellate Body.

7. Basic Rationale under Article 12.7 of the DSU

489. The United States contends that, contrary to Article 12.7 of the DSU, the Panel failed to set out the basic rationale behind its finding that the effect of the price-contingent subsidies is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*. Article 12.7 of the

<sup>672</sup>*Ibid.*, para. 7.1390.

<sup>673</sup>*Ibid.*, para. 7.1391.

<sup>674</sup>United States' Notice of Appeal (WT/DS267/17, 18 October 2004, attached as Annex 1 to this Report), para. 8(i); United States' appellant's submission, para. 516(8)(i).

<sup>675</sup>Brazil's appellee's submission, para. 1084.

<sup>676</sup>Panel Report, paras. 7.1395 and 8.1(g)(i).

<sup>677</sup>*Supra*, para. 485.

DSU requires a panel to set out in its report "the findings of fact, the applicability of relevant provisions and the basic rationale behind any findings and recommendations that it makes".

490. The United States submits that the Panel "provided no explanation of what degree of price suppression it had found to be 'significant'."<sup>678</sup> In fact, the Panel based its reasoning in this regard on the ordinary meaning of "significant"<sup>679</sup>, explaining that the "significance" of price suppression could, depending on the circumstances, have both quantitative and qualitative aspects.<sup>680</sup> We find that the Panel adequately explained the basis for its conclusion that the price suppression it had found was "significant" with the meaning of Article 6.3(c).<sup>681</sup> We therefore see no failure on the part of the Panel to comply with Article 12.7 of the DSU in this regard.

491. The United States also argues that the Panel "failed to set out the basic rationale behind its findings and recommendations ... with respect to the amount of the subsidy."<sup>682</sup> We have already held that the Panel did not err in interpreting or applying Article 6.3(c) of the *SCM Agreement* in relation to the amount of the challenged subsidies.<sup>683</sup> In addition, we note that the Panel articulated a basic rationale for its conclusions in this regard.<sup>684</sup> Accordingly, we decline to find an error on the part of the Panel under Article 12.7 of the DSU.

492. In addition, the United States contends that, contrary to Article 12.7 of the DSU, the Panel failed to set out the basic rationale behind several steps in its reasoning leading to the conclusion that the effect of the price-contingent subsidies is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*. The United States contends that the Panel "prejudged ... the outcome of its causation analysis" in making its finding of price suppression<sup>685</sup> and that the Panel

<sup>678</sup>United States' appellant's submission, para. 330.

<sup>679</sup>Panel Report, para. 7.1325 (referring to *The New Shorter Oxford English Dictionary* (1993)).

<sup>680</sup>"The 'significance' of any degree of price suppression ... may not solely depend upon a given level of numeric significance". (Panel Report, para. 7.1329)

<sup>681</sup>Panel Report, paras. 7.1316-7.1333.

<sup>682</sup>United States' appellant's submission, para. 326.

<sup>683</sup>*Supra*, para. 473.

<sup>684</sup>Panel Report, paras. 7.1166-7.1190. In assessing the need to quantify the benefit conferred on upland cotton by the subsidies at issue, the Panel compared the specific provisions in Parts III and V of the *SCM Agreement*, as well as certain aspects of Articles VI and XVI of the GATT 1994. It highlighted the different remedies contained in the provisions of Part III and V and the rationale behind these different parts. The Panel identified the specific arguments of the United States that it was addressing as well as the relevant Appellate Body pronouncements. The Panel's basic rationale for deciding that it need not quantify precisely the benefit conferred on upland cotton by the subsidies at issue appears to have been that "the more precise quantitative concepts and methodologies found in Part V of the *SCM Agreement* are not directly applicable in our examination of Brazil's actionable subsidy claims under Part III of the *SCM Agreement*". (Panel Report, para. 7.1167)

<sup>685</sup>United States' appellant's submission, para. 325.

"never explained why it did not analyze the farmer's planting decision and the use of expected prices."<sup>686</sup> In the present dispute, the Panel set out the basic rationale for its findings on "significant price suppression" and the "causal link" with the price-contingent subsidies.<sup>687</sup> As we have already explained, the Panel did address the "planting decision" and "expected prices"<sup>688</sup>, and the overlap between different sections of the Panel's analysis stemmed in part from the elements that constitute "price suppression" under Article 6.3(c).<sup>689</sup>

493. In its appellant's submission, the United States argues that the Panel failed to comply with Article 12.7 of the DSU, *inter alia*, in making its findings as to: (i) "why the processed cotton was a 'subsidized product' and why [the Panel] could assume that all of the subsidies paid to cotton producers for raw cotton passed through to the processor"<sup>690</sup>; and (ii) "why any price suppression that it found meant that there was serious prejudice to the interests of Brazil".<sup>691</sup>

494. However, paragraph 10 of the United States' Notice of Appeal (which contains the United States' allegations in connection with Article 12.7 of the DSU) does not refer to the "subsidized product", "pass through", or "serious prejudice". Nor does the general statement in paragraph 10 of the issues covered in the United States' claim under Article 12.7 of the DSU appear to extend to these two findings.<sup>692</sup>

495. We acknowledge that the wording of paragraph 10 of the United States' Notice of Appeal (and, in particular, the use of the words "for example") suggests that the findings listed in this paragraph are simply *examples* of findings challenged in connection with Article 12.7 of the DSU, and that the United States' claim of error under Article 12.7 extends to other Panel findings. In other words, paragraph 10 purports to provide an illustrative rather than exhaustive list of the findings that the United States intends to challenge under Article 12.7 of the DSU. However, the fact that paragraph 10 purports to provide an illustrative list is not conclusive as to whether the Notice of

<sup>686</sup>*Ibid.*, para. 324.

<sup>687</sup>Panel Report, paras. 7.1275-7.1363. The Panel referred to and addressed a great deal of factual evidence provided by the parties. The Panel also clearly identified the provisions of the covered agreements that it considered relevant to this issue and gave detailed explanations for its conclusions at each step.

<sup>688</sup>*Supra*, para. 441.

<sup>689</sup>*Supra*, para. 433.

<sup>690</sup>United States' appellant's submission, para. 328.

<sup>691</sup>*Ibid.*, para. 329.

<sup>692</sup>It could be argued that the "pass-through" issue is encompassed in the reference to "the amount of the challenged subsidies" in paragraph 10. However, if the United States wished to include this issue in its claim of error under Article 12.7, as described in paragraph 10 of the Notice of Appeal, one might have expected it to do so more explicitly, given that a substantive claim of error regarding the need for a "pass-through" analysis is raised specifically in paragraph 8(d) of the Notice of Appeal in respect of the issues appealed regarding "serious prejudice".

Appeal contains a sufficient reference to the Panel's findings described in paragraph 493 above for us to conclude that these findings are included in the United States' appeal. The significance of terms such as "for example" is likely to depend on the particular claim in question and the particular context in which the term is used in a given appeal. In our view, the United States' Notice of Appeal did not provide adequate notice to Brazil, as contemplated by Rule 20(2) of the *Working Procedures for Appellate Review* (the "*Working Procedures*")<sup>693</sup>, that the United States intended to make a claim of error under Article 12.7 of the DSU with respect to the Panel's findings described in paragraph 493 above. We therefore decline to rule on these findings in connection with Article 12.7 of the DSU.

#### 8. Conclusion

496. For these reasons, the United States has not persuaded us that the Panel committed a legal error in interpreting the relevant legal requirements of Article 6.3(c) or in applying its interpretation to the facts of this case. We therefore *uphold* the Panel's finding, in paragraphs 7.1416 and 8.1(g)(i) of the Panel Report, that the effect of marketing loan program payments, Step 2 payments, market loss assistance payments, and counter-cyclical payments is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*.<sup>694</sup> We also find that the Panel set out the findings of fact, the applicability of relevant provisions, and the basic rationale behind this finding, as required by Article 12.7 of the DSU.

#### B. *World Market Share under Article 6.3(d) of the SCM Agreement*

##### 1. Introduction

497. In addition to its claim that it had suffered serious prejudice resulting from price suppression under Article 6.3(c) of the *SCM Agreement*, Brazil also made claims before the Panel alleging that the effect of the challenged subsidies was serious prejudice resulting from an increase in the United States' world market share in upland cotton under Article 6.3(d) of that Agreement.<sup>695</sup> The principal disagreement between the parties regarding the application of Article 6.3(d) related to the meaning of the phrase contained therein, "world market share". Brazil submitted that this phrase meant "a Member's share of the world market for exports"<sup>696</sup>, and put forward evidence regarding increases in

<sup>693</sup>See *supra*, footnote 18.

<sup>694</sup>See *supra*, para. 488.

<sup>695</sup>The Panel listed the following as subsidies at issue for purposes of Brazil's claim under Article 6.3(d) of the *SCM Agreement*: "user marketing (Step 2) payments to domestic users and exporters; marketing loan programme payments; [production flexibility contract] payments; [market loss assistance] payments; [direct] payments; [counter-cyclical] payments; crop insurance payments; and cottonseed payments". (Panel Report, para. 7.1418) (footnote omitted)

<sup>696</sup>Panel Report, para. 7.1424. (footnote omitted)

the United States' share of the world market for exports of upland cotton. The United States contended that the United States' share of the "world market" for upland cotton encompassed all consumption of all upland cotton, including consumption by a country of its own cotton production.<sup>697</sup>

498. The Panel rejected Brazil's contention that the "world market share" referred to in Article 6.3(d) was limited to the world market for exports.<sup>698</sup> The Panel also rejected the United States' argument that "world market share" focuses on a Member's share of consumption, based largely upon an interpretation of the object and purpose of subsidies disciplines<sup>699</sup> and logical inconsistencies in the United States' arguments.<sup>700</sup> Instead, the Panel reached the view that:

... the phrase "world market share" of the subsidizing Member in Article 6.3(d) of the *SCM Agreement* refers to share of the world market supplied by the subsidizing Member of the product concerned.<sup>701</sup>

499. In view of the fact that the evidence and argumentation submitted by Brazil "focused exclusively upon a different, and in [the Panel's] view erroneous, legal interpretation of the phrase 'world market share' in Article 6.3(d)", the Panel found that "Brazil has not established a prima facie case of violation of Article 6.3(d) or Article 5(c) of the *SCM Agreement*".<sup>702</sup>

500. Brazil appeals the Panel's finding that it failed to make a *prima facie* case of violation under Article 6.3(d) (and Article 5(c)) of the *SCM Agreement*. Its appeal has two sequential elements. First, Brazil appeals the Panel's legal interpretation of Article 6.3(d). Brazil stresses that its appeal regarding the Panel's legal interpretation of the phrase "world market share" is *not conditional*.<sup>703</sup> Brazil suggests that the text of Article 6.3(d) is silent on the question of whether "world market share" refers to world market share of *exports* or world market share of something else.<sup>704</sup> However, the use of the word "*trade*" in footnote 17 to Article 6.3(d) (in the context of "multilaterally agreed specific rules apply to the trade in the product or commodity") suggests that the focus of the provision is upon a Member's share of world *trade* in a product, which requires a focus on *exports*, not

<sup>697</sup>*Ibid.*, para. 7.1425.

<sup>698</sup>*Ibid.*, paras. 7.1438-7.1450, and 7.1455-7.1463.

<sup>699</sup>*Ibid.*, paras. 7.1451-7.1453.

<sup>700</sup>*Ibid.*, footnote 1527 to para. 7.1451.

<sup>701</sup>*Ibid.*, para. 7.1464. (underlining added)

<sup>702</sup>*Ibid.*, para. 7.1465. (footnote omitted)

<sup>703</sup>Brazil's other appellant's submission, para. 264.

<sup>704</sup>*Ibid.*, para. 275.

production, as the Panel found.<sup>705</sup> Brazil argues that Article XVI:3 of the GATT 1994 addresses a Member's "share of world export trade" and that structural similarities between Article XVI:3 and Article 6.3(d) require the phrase "world market share" in the latter provision to be read in the same way.<sup>706</sup> Brazil also points to the context provided by paragraphs (a) and (b) of Article 6.3, as well as Articles 6.4 and 6.7, and argues that the focus of a serious prejudice analysis under Article 6.3 is on the effects of the subsidies on like products from the complaining Member.<sup>707</sup> In addition, Brazil argues that the Panel's reasoning subverts the object and purpose of the *SCM Agreement*, which is to reduce trade distortions caused by subsidies. The Panel's reading denies any remedy to countries that lose market share to subsidized products.<sup>708</sup>

501. Secondly, Brazil requests us to complete the analysis of its claim of serious prejudice under Article 6.3(d). Brazil makes this element of its appeal *conditional* upon us reversing the Panel's findings that United States price-contingent subsidies<sup>709</sup> caused significant price suppression in terms of Article 6.3(c) of the *SCM Agreement*. Brazil submits that findings by the Panel and undisputed facts on the record would allow us to complete the analysis and find a violation of Article 6.3(d) by the United States.<sup>710</sup>

502. The United States counters that the Panel was correct to reject the Brazilian interpretation that "world market share" in Article 6.3(d) means "world market share of exports". The Panel correctly reasoned that nothing in the ordinary meaning of "world market share" suggests that it should not include the domestic market of the Member concerned.<sup>711</sup> The United States recalls that the Panel distinguished between Article 6.3(d) (which deals with "world market share") and Article XVI:3 of GATT 1994 (which deals with "share of world export trade") and suggests that the distinct choice of words reflected in these provisions contains important context to suggest that the coverage of Article 6.3(d) is different from that of Article XVI:3.<sup>712</sup> The United States rebuts Brazil's arguments

<sup>705</sup>Brazil's other appellant's submission, paras. 276-277.

<sup>706</sup>*Ibid.*, paras. 275-280.

<sup>707</sup>*Ibid.*, paras. 281-288.

<sup>708</sup>*Ibid.*, paras. 289-294.

<sup>709</sup>That is, marketing loan program payments, Step 2 payments, market loss assistance payments and counter-cyclical payments.

<sup>710</sup>Brazil's other appellant's submission, paras. 296-315.

<sup>711</sup>Indeed (and although the United States does not appeal this point) the United States stresses that the Panel's interpretation that the focus in the phrase "world market share" is upon production is too narrow, because it focuses only on *supply* in the world "market" and not upon *demand*. A correct interpretation would take into account demand—that is *consumption*—as well. On this basis, the focus in Article 6.3(d) is not upon a share of the world's supply or production, but rather upon total *sales*. (United States' appellee's submission, paras. 148-152)

<sup>712</sup>United States' appellee's submission, para. 153.

regarding footnote 17 to Article 6.3(d) by stressing that the term "trade" in the footnote does not purport to limit the scope of the otherwise broad term "world market share" in the text of Article 6.3(d) itself.<sup>713</sup> Other elements of the context in which Article 6.3(d) appears, such as paragraphs (a) and (b) of Article 6.3 and Articles 6.4 and 6.7 of the *SCM Agreement*, explicitly limit the aspects of the market that they address. This contrasts with Article 6.3(d), which focuses only upon the general concept "world market share". The United States also contests Brazil's view that the Panel's interpretation of Article 6.3(d) reduces the provision to inutility.<sup>714</sup> With respect to Brazil's conditional request to complete the analysis, the United States submits that, even if the Appellate Body accepts Brazil's arguments with respect to the interpretation of Article 6.3(d), there are insufficient facts available for the Appellate Body to complete the analysis of Brazil's claim on this matter. The United States observes that the Panel did not undertake an analysis regarding a causal link between the subsidies at issue and an increase in the United States' world market share of exports in upland cotton, and that the causation analysis regarding price suppression under 6.3(c) could not be transposed into an analysis of world market share under Article 6.3(d).<sup>715</sup>

503. Benin and Chad, third participants in this appeal, support Brazil's interpretation of the phrase "world market share" in Article 6.3(d) of the *SCM Agreement*.<sup>716</sup> Benin and Chad argue that, in the event we agree with Brazil that "world market share" refers to a Member's share of world exports, then we should complete the analysis. In the view of Benin and Chad, the undisputed evidence on record demonstrates that the effect of the United States' subsidies is serious prejudice to the interests of Benin and Chad as well, within the meaning of Articles 6.3(d) and 5(c) of the *SCM Agreement*. Benin and Chad submit that the "interests of another Member" in Article 5(c) are not limited only to the interests of the complaining Member and ask us to find accordingly.<sup>717</sup>

## 2. Analysis

504. Article 6.3 of the *SCM Agreement* provides, in relevant part:

Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply:

...

<sup>713</sup>*Ibid.*, paras. 154-156.

<sup>714</sup>*Ibid.*, para. 161.

<sup>715</sup>*Ibid.*, paras. 163-165.

<sup>716</sup>Benin and Chad's third participants' submission, paras. 75-79.

<sup>717</sup>*Ibid.*, paras. 80-91.

(d) the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity<sup>719</sup> as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted.

<sup>717</sup> Unless other multilaterally agreed specific rules apply to the trade in the product or commodity in question.

505. As we have noted above, the four subparagraphs of Article 6.3 describe circumstances in which a subsidy has certain effects, which, in turn, may constitute serious prejudice under Article 5(c).<sup>718</sup> Article 6.3(d) addresses a situation in which subsidies have the effect of increasing the "world market share of the subsidizing Member in a particular subsidized product or commodity". The Panel held that the phrase "world market share" of the subsidizing Member in Article 6.3(d) of the *SCM Agreement* "refers to share of the world market *supplied* by the subsidizing Member of the product concerned".<sup>719</sup> As Brazil had failed to submit evidence pertaining to this legal interpretation, the Panel found that Brazil had failed to make a *prima facie* case of violation of this provision.<sup>720</sup>

506. Brazil's appeal with respect to the application of Article 6.3(d) of the *SCM Agreement* has two elements. First, Brazil appeals the Panel's interpretation of the phrase "world market share" in that provision. Second, Brazil requests us to complete the analysis of this issue and rule that the effect of certain United States subsidies is an increase in the world market share of the United States in upland cotton. This second element of Brazil's appeal is *conditional* upon us reversing the Panel's findings with respect to the interpretation of Article 6.3(c) of the *SCM Agreement*.

<sup>718</sup> On the relationship between Articles 5(c) and 6.3 of the *SCM Agreement*, see *supra*, paras. 485-488.

<sup>719</sup> Panel Report, para. 7.1464. (emphasis added)

<sup>720</sup> *Ibid.*, para. 7.1465.

507. We observe with regard to the interpretation of the phrase "world market share" in Article 6.3(d) that, above<sup>721</sup>, we upheld the Panel's finding that the effect of the price-contingent subsidies at issue in these proceedings is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*. We observe, therefore, that the condition upon which the second part of Brazil's appeal is contingent is *not* fulfilled, and thus there is no need for us to complete the analysis and to examine whether or not the United States subsidies at issue have the effect of increasing the United States' world market share in upland cotton.

508. Nor do we believe that it is necessary to make a finding on the interpretation of the phrase "world market share" in Article 6.3(d) of the *SCM Agreement*. We recall that Article 17.12 of the DSU requires that the "Appellate Body shall address each of the issues raised in accordance with paragraph 6 [of Article 17] during the appellate proceeding". In addition, we note that Article 3.3 of the DSU explains that:

The prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is essential to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members.

For its part, Article 3.4 of the DSU provides that "[r]ecommendations or rulings made by the DSB shall be aimed at achieving a satisfactory settlement of the matter". Similarly, Article 3.7 states that "[t]he aim of the dispute settlement mechanism is to secure a positive solution to a dispute".

509. In *US – Wool Shirts and Blouses*, the Appellate Body cautioned that:

Given the explicit aim of dispute settlement that permeates the *DSU*, we do not consider that Article 3.2 of the *DSU* is meant to encourage either panels or the Appellate Body to "make law" by clarifying existing provisions of the *WTO Agreement* outside the context of resolving a particular dispute.<sup>722</sup>

510. With this in mind, we observe that although an interpretation by the Appellate Body, in the abstract, of the meaning of the phrase "world market share" in Article 6.3(d) of the *SCM Agreement*

<sup>721</sup> *Supra*, para. 496.

<sup>722</sup> Appellate Body Report, *US – Wool Shirts and Blouses*, p. 19, DSR 1997:1, 323 at 340.

might offer at best some degree of "guidance" on that issue, it would not affect the resolution of this particular dispute.<sup>723</sup> Indeed, irrespective of whether we were to uphold or reverse the Panel's finding on this issue, upon adoption of the recommendations and rulings by the DSB, the United States would be under no additional obligation regarding implementation. Thus, although we recognize that there may be cases in which it would be useful for us to review an issue, despite the fact that our ruling would not result in rulings and recommendations by the DSB, we find no compelling reason for doing so in this case.

511. Accordingly, we believe that an interpretation of the phrase "world market share" in Article 6.3(d) of the *SCM Agreement* is unnecessary for purposes of resolving this dispute. We emphasize that we neither uphold nor reverse the Panel's findings on the interpretation of the phrase "world market share" in Article 6.3(d) of the *SCM Agreement*.

512. Finally, we recall that Article 24.1 of the DSU requires that "[a]t all stages of the determination of the causes of a dispute and of dispute settlement procedures involving a least-developed country Member, particular consideration shall be given to the special situation of least-developed country Members". We fully recognize the importance of this provision. However, we recall that Benin and Chad request us to find that their interests have suffered serious prejudice in the sense of Article 5(c) of the *SCM Agreement*, if we find Brazil has suffered serious prejudice as a result of an increase in the United States' world market share in upland cotton in the sense of Article 6.3(d) of the *SCM Agreement*. As we do not find it necessary to rule on Brazil's appeal regarding the interpretation of the phrase "world market share" in Article 6.3(d), we therefore are not in a position to accede to Benin and Chad's request to complete the analysis and to find that, in addition to Brazil, Benin and Chad also have suffered serious prejudice to their interests in the sense of Articles 6.3(d) and 5(c) of the *SCM Agreement*. We note that Benin and Chad's request to complete the analysis was predicated upon us reversing the Panel's interpretation of the phrase "world market share" in Article 6.3(d) of the *SCM Agreement*.<sup>724</sup> This condition is not met.

<sup>723</sup>We note, in this regard, that, in *US – Steel Safeguards*, the Appellate Body noted that "several participants expressed an interest in having [it] rule on causation as it would provide guidance to Members on applying safeguard measures in the future consistently with their WTO obligations". (*Appellate Body Report, US – Steel Safeguards*, para. 484) Despite this request for guidance, the Appellate Body declined to make a ruling on this specific aspect of the case. (*Appellate Body Report, US – Steel Safeguards*, para. 483)

<sup>724</sup>Benin and Chad's third participants' submission, para. 83.

## VII. Import Substitution Subsidies and Export Subsidies

### A. Step 2 Payments to Domestic Users

#### 1. Introduction

513. We examine next the United States' claims against the Panel's findings relating to the Step 2 payments provided to domestic users and exporters of United States upland cotton under Section 1207(a) of the FSRI Act of 2002.

514. According to the Panel<sup>725</sup>, the program pursuant to which Step 2 payments are granted has been authorized since 1990 under successive legislation, including the FAIR Act of 1996<sup>726</sup> and the FSRI Act of 2002.<sup>727</sup> Under the program, marketing certificates or cash payments (collectively referred to by the Panel as "user marketing (Step 2) payments")<sup>728</sup> are issued to eligible domestic users and exporters of eligible upland cotton when certain market conditions exist such that United States cotton pricing benchmarks are exceeded. "Eligible upland cotton" is defined as "domestically produced baled upland cotton which bale is opened by an eligible domestic user ... or exported by an eligible exporter".<sup>729</sup> An "eligible domestic user" of upland cotton is defined under the regulations as:

A person regularly engaged in the business of opening bales of eligible upland cotton for the purpose of manufacturing such cotton into cotton products in the United States (domestic user), who has entered into an agreement with CCC<sup>730</sup> to participate in the upland cotton user marketing certificate program.<sup>731</sup>

<sup>725</sup>Panel Report, para. 7.209.

<sup>726</sup>Section 136 of the FAIR Act of 1996, reproduced in Exhibits BRA-28 and US-22.

<sup>727</sup>Section 1207 of the FSRI Act of 2002, reproduced in Exhibits BRA-29 and US-1, implemented under 7 CFR 1427, Subpart C, reproduced in Exhibit BRA-37.

<sup>728</sup>The Panel explained that "[f]or the purposes of this dispute, on the basis of the views of the parties, we make no distinction between user marketing (Step 2) cash payments and marketing certificates". (Panel Report, footnote 284 to para. 7.209, referring to Brazil's and the United States' respective responses to Panel Question No. 110 (a))

<sup>729</sup>7 CFR Section 1427.103(a).

<sup>730</sup>Additional information about the CCC is provided, *infra*, footnote 859; see also Panel Report, para. 7.702.

<sup>731</sup>7 CFR Section 1427.104(a)(1).

515. For its part, an "eligible exporter" of upland cotton is:

A person, including a producer or a cooperative marketing association ... regularly engaged in selling eligible upland cotton for exportation from the United States (exporter), who has entered into an agreement with CCC to participate in the upland cotton user marketing certificate program.<sup>732</sup>

516. The Panel explained that, under the FAIR Act of 1996, the United States Secretary of Agriculture "issued user marketing (Step 2) payments to domestic users and exporters of upland cotton for documented purchases by domestic users and sales for export by exporters made in a week following a consecutive four-week period when the lowest price quotation for United States cotton delivered to Northern Europe exceeded the Northern Europe price quotation by more than 1.25 cents per pound, and the adjusted world price did not exceed 130 per cent of the marketing loan rate for upland cotton."<sup>733</sup> The payments to domestic users and exporters are calculated "at a rate per pound equal to the difference between the two price quotations during the fourth week of the period, minus the 1.25 cents per pound threshold".<sup>734</sup> Step 2 payments continued to be authorized under the FSRI Act of 2002, although with certain modifications. The Panel pointed out that "[i]n particular, application of the 1.25 cents per pound threshold has been delayed until 1 August 2006 (i.e. for the 2002 through 2005 marketing years)".<sup>735</sup> The consequence of this, the Panel explained, is that "Step 2 payments are issued following a consecutive four-week period when the lowest price quotation for United States cotton delivered to Northern Europe exceeded the Northern Europe price quotation by any amount and the adjusted world price did not exceed 134 per cent (not 130 per cent, as under the FAIR Act of 1996) of the marketing loan rate".<sup>736</sup> Domestic users and exporters receive payments that are calculated "at a rate per pound equal to the difference between the two price quotations during the fourth week of the period, with no reduction for the threshold".<sup>737</sup>

517. We address first the United States' appeal of the Panel findings in respect of Step 2 payments to *domestic users* of United States upland cotton. We examine the United States' appeal of the

<sup>732</sup> 7 CFR Section 1427.104(a)(2).

<sup>733</sup> Panel Report, para. 7.210.

<sup>734</sup> *Ibid.*, para. 7.210 (referring to Section 136(a) of the FAIR Act of 1996 reproduced in Exhibits BRA-28 and US-22). The Panel added that Section 136(a)(5) limited total expenditures under this program to \$701 million, but this was later repealed. (*Ibid.*, footnote 286 to para. 7.210)

<sup>735</sup> *Ibid.*, para. 7.211.

<sup>736</sup> *Ibid.*

<sup>737</sup> *Ibid.*, para. 7.211 (referring to Section 1207(a) of the FSRI Act of 2002, reproduced in Exhibits BRA-29 and US-1, and 7 CFR 1427.107 (1 January 2003 edition), reproduced in Exhibit BRA-37).

Panel's finding in respect of Step 2 payments to *exporters* of United States upland cotton in the next Section of this Report.

## 2. Panel Findings

518. Before the Panel, Brazil argued that Step 2 payments to domestic users of upland cotton are *per se* import substitution subsidies that are inconsistent with Articles 3.1(b) and 3.2 of the *SCM Agreement*.<sup>738</sup> Brazil explained that Step 2 payments to domestic users are "contingent on the use of domestic over imported goods within the meaning of Article 3.1(b) of the *SCM Agreement*" because the payments "are 'conditional' on proof of consumption of domestically produced upland cotton".<sup>739</sup>

519. The United States did not dispute that Step 2 payments are "subsidies" and that to receive a Step 2 payment a domestic user must "open a bale of domestically produced baled upland cotton".<sup>740</sup> The United States, however, asserted that Step 2 payments to domestic users of upland cotton are included, and they comply with, the United States' domestic support reduction commitments pursuant to Article 6.3 of the *Agreement on Agriculture*.<sup>741</sup> As Step 2 payments to domestic users are permitted under the *Agreement on Agriculture*, the United States argued that these payments cannot be contrary to Article 3 of the *SCM Agreement*. This is because the introductory language of Article 3.1 of the *SCM Agreement* makes it clear that that provision applies "[e]xcept as provided in the *Agreement on Agriculture*".<sup>742</sup> The United States additionally asserted that "pursuant to Article 21 of the *Agreement on Agriculture*, all of the Annex 1A agreements (including the *SCM Agreement*) apply subject to the provisions of the *Agreement on Agriculture*".<sup>743</sup>

520. The Panel began its examination by observing that "[t]he introductory clause of Article 3.1 of the *SCM Agreement* ([e]xcept as provided in the *Agreement on Agriculture*) indicates that any examination of the WTO-consistency of a subsidy for agricultural products under the *SCM*

<sup>738</sup> Panel Report, para. 7.1019. Before the Panel, Brazil also claimed that Step 2 payments to *domestic users* are contrary to Article III:4 of the GATT 1994 and that they are not justified under Article III:8(b) because they are not exclusively paid to domestic *producers* of cotton, but rather to domestic *users*.

The Panel exercised judicial economy in respect of this claim, in the light of the fact that it had already found the same measure to be inconsistent with Articles 3.1(b) and 3.2 of the *SCM Agreement*. Brazil has not appealed the Panel's exercise of judicial economy. (*Ibid.*, paras. 7.1099 and 7.1106)

<sup>739</sup> *Ibid.*, para. 7.1019.

<sup>740</sup> *Ibid.*, para. 7.1022 (quoting the United States' response to Question 144 Posed by the Panel (Panel Report, p. I-128, para. 217 and p. I-249, para. 58)).

<sup>741</sup> *Ibid.*, para. 7.1023.

<sup>742</sup> *Ibid.*, para. 7.1024.

<sup>743</sup> *Ibid.*

*Agreement* may depend upon the provisions of the *Agreement on Agriculture*.<sup>744</sup> The Panel then examined Article 21.1 of the *Agreement on Agriculture* and observed that this provision "expressly acknowledges the application of the *GATT 1994* and the *SCM Agreement* to agricultural products, while indicating that the *Agreement on Agriculture* would take precedence in the event, and to the extent, of any conflict".<sup>745</sup> The Panel described the situations in which, in its view, Article 21.1 of the *Agreement on Agriculture* applies<sup>746</sup>, and then turned to "the relevant provisions of the *Agreement on Agriculture* in order to discern whether, and/or to what extent, these provisions affect a claim concerning the prohibition on import substitution subsidies in Article 3.1(b) of the *SCM Agreement*."<sup>747</sup> The Panel concluded that "none of the situations" it described arises in this dispute from the relevant provisions in the *Agreement on Agriculture*.<sup>748</sup>

521. The Panel examined Article 13 of the *Agreement on Agriculture*, but concluded that this provision did not affect its analysis of Brazil's claims under Article 3.1(b) of the *SCM Agreement*.<sup>749</sup> The Panel then looked at Article 6.3 and paragraph 7 of Annex 3 of the *Agreement on Agriculture*, rejecting the United States' contention that "user marketing (Step 2) payments to upland cotton domestic users that provide support to domestic producers contingent on the use of domestic goods [are] consistent with the *Agreement on Agriculture*".<sup>750</sup> The Panel reasoned instead that:

Article 6.3 does not provide that compliance with such "domestic support reduction commitments" shall necessarily be considered to be in compliance with other applicable WTO obligations. Nor does it contain an explicit textual indication that otherwise prohibited measures are necessarily justified by virtue of compliance with the domestic support reduction commitments. The obligations are parallel, and the operation of Article 6.3 of the *Agreement on Agriculture* does not pre-empt or exclude the operation of the obligation under Article 3.1(b) of the *SCM Agreement*.<sup>751</sup>

522. From this the Panel concluded that "Article 3.1(b) of the *SCM Agreement* can be read together with the *Agreement on Agriculture* provisions relating to domestic support in a coherent and consistent manner which gives full and effective meaning to all of their terms".<sup>752</sup> Accordingly, the

<sup>744</sup> Panel Report, para. 7.1034. (footnote omitted)

<sup>745</sup> *Ibid.*, para. 7.1036.

<sup>746</sup> *Ibid.*, para. 7.1038. See *infra*, para. 532.

<sup>747</sup> *Ibid.*, para. 7.1041. (footnote omitted)

<sup>748</sup> *Ibid.*, para. 7.1039.

<sup>749</sup> *Ibid.*, para. 7.1052.

<sup>750</sup> *Ibid.*, para. 7.1056.

<sup>751</sup> *Ibid.*, para. 7.1058. (original emphasis)

<sup>752</sup> *Ibid.*, para. 7.1071.

Panel found no conflict between the domestic support provisions of the *Agreement on Agriculture* and Article 3.1(b) of the *SCM Agreement* and, therefore, saw no necessity to apply the rules in Article 21.1 of the *Agreement on Agriculture*.<sup>753</sup>

523. Having examined the relationship between the relevant provisions of the *Agreement on Agriculture* and the *SCM Agreement*, the Panel proceeded to examine whether the Step 2 payments to domestic users are contingent on the use of domestic products contrary to Article 3.1(b) of the *SCM Agreement*. The Panel noted that the United States had acknowledged that "to receive a payment under the user marketing (Step 2) programme, a domestic user must open a bale of domestically produced baled upland cotton" and, therefore, did "not dispute that user marketing (Step 2) payments to domestic users constitute a subsidy conditional or dependent upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the *SCM Agreement*".<sup>754</sup> The Panel also conducted its own examination and found that:

... user marketing (Step 2) payments to domestic users under section 1207(a) of the FSRI Act of 2002 will not be made except upon proof of consumption of eligible upland cotton – which must be "domestically produced", and "not imported". It is not just that it will invariably be easier for domestic users to meet the conditions for user marketing (Step 2) payments to domestic users by using domestic -- rather than imported -- upland cotton. The text of the measure explicitly *requires* the use of domestically produced upland cotton as a pre-condition for receipt of the payments.

The use of United States domestically produced upland cotton is a condition for obtaining the subsidy. User marketing (Step 2) payments to domestic users under section 1207(a) of the FSRI Act of 2002 are clearly conditional, or dependent upon, such use.<sup>755</sup>

524. The Panel, furthermore, recalled its finding that the "fact that the user marketing (Step 2) payments are also available in another factual situation ... —i.e. exporters—would not have the effect of dissolving such contingency in respect of domestic users, particularly ... where the other factual contingency (upon export performance) also gives rise to a prohibited subsidy".<sup>756</sup>

<sup>753</sup> Panel Report, para. 7.1071.

<sup>754</sup> *Ibid.*, para. 7.1082 (referring to the United States' response to Question 144 Posed by the Panel (Panel Report, p. I-249, para. 58) and Appellate Body Report, *Canada – Autos*, para. 126). (footnotes omitted)

<sup>755</sup> *Ibid.*, paras. 7.1085-7.1086. (original emphasis)

<sup>756</sup> *Ibid.*, para. 7.1087.

525. Therefore, the Panel concluded that "section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to domestic users is inconsistent with Article 3.1(b) of the *SCM Agreement*".<sup>757</sup> In addition, the Panel found that "[t]o the extent that section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to domestic users is inconsistent with Article 3.1(b), it is, consequently, also inconsistent with Article 3.2 of the *SCM Agreement*".<sup>758</sup>

### 3. Arguments on Appeal

526. On appeal, the United States requests us to reverse the Panel's findings. According to the United States, the Panel's conclusion fails to give meaning to the introductory phrase "[e]xcept as provided in the Agreement on Agriculture" of Article 3.1 of the *SCM Agreement*.<sup>759</sup> This phrase not only applies to export subsidies covered by Article 3.1(a) of the *SCM Agreement*, but also to import substitution subsidies covered by Article 3.1(b). The United States contends that Step 2 payments to domestic users are properly classified as domestic support subject to reduction commitments under Article 6 of the *Agreement on Agriculture*.<sup>760</sup> Indeed, paragraph 7 of Annex 3 requires that measures directed at agricultural processors shall be included in the AMS to the extent that such measures benefit the producers of the basic agricultural products. This approach is consistent with the objective of the *Agreement on Agriculture* of providing for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time.<sup>761</sup> Furthermore, the United States argues that the lack of any reference to domestic content subsidies in Article 13(b) of the *Agreement on Agriculture* does not support the Panel's interpretation.<sup>762</sup> Article 13(b) does not refer to Article 3 of the *SCM Agreement* because the substantive obligation of Article 3.1(b) does not apply in the case of domestic content subsidies in favour of agricultural producers.

527. Brazil requests that we uphold the Panel's findings. According to Brazil, "[t]he obligations in the *Agreement on Agriculture* and the *SCM Agreement* apply cumulatively, unless there is an exception or a conflict".<sup>763</sup> In Brazil's view, no conflict arises. Under the *Agreement on Agriculture*, WTO Members enjoy a right to grant domestic support in favour of agricultural producers. However, this does not create a conflict with Article 3.1(b) of the *SCM Agreement*, because it is perfectly possible for Members to grant domestic support without making payments contingent on domestic

<sup>757</sup>Panel Report, para. 7.1097. (footnote omitted)

<sup>758</sup>*Ibid.*, para. 7.1098.

<sup>759</sup>United States' appellant's submission, paras. 429-430.

<sup>760</sup>*Ibid.*, para. 434.

<sup>761</sup>*Ibid.*, para. 435.

<sup>762</sup>*Ibid.*, paras. 431-432.

<sup>763</sup>Brazil's appellee's submission, para. 75.

content. In other words, Members can fully enjoy their right to grant domestic support *and* comply with Article 3.1(b).<sup>764</sup>

528. Brazil asserts that this interpretation is consistent with a primary objective of the covered agreements, namely, avoiding discrimination under the national treatment rule. It is also consistent with an adopted 1958 GATT panel report involving a subsidy to agricultural producers that was contingent on purchase of domestic goods.<sup>765</sup> Thus, Brazil states that domestic content subsidies in favour of agricultural producers have been understood to be impermissible since 1958, so there is nothing novel about Brazil's complaint.<sup>766</sup> The *Agreement on Agriculture* did not mark a step back to allowing discrimination and protection that was prohibited under the GATT 1947. Therefore, domestic support under the *Agreement on Agriculture* can and must be granted consistently with Article 3.1(b) of the *SCM Agreement* and Article III:4 of the GATT 1994.<sup>767</sup>

### 4. Does Article 3.1(b) of the SCM Agreement Apply to Agricultural Products?

529. At the outset, we note that the United States did not dispute before the Panel that, if the *SCM Agreement* were applicable, "user marketing (Step 2) payments to domestic users [would] constitute a subsidy conditional or dependent upon the use of domestic over imported goods within the meaning of Article 3.1(b)" of that Agreement.<sup>768</sup> Instead, before the Panel and on appeal, the United States asserts that Article 3.1(b) of the *SCM Agreement* is inapplicable to Step 2 payments to domestic users because these payments are consistent with the United States' domestic support reduction commitments under the *Agreement on Agriculture*.<sup>769</sup>

<sup>764</sup>Brazil's appellee's submission, para. 867.

<sup>765</sup>*Ibid.*, para. 860 (referring to GATT Panel Report, *Italy – Agricultural Machinery*, para. 16). According to Brazil, that panel recognized that the GATT contracting parties were entitled to grant support to agricultural producers but found that this could be done without granting domestic content subsidies.

<sup>766</sup>Brazil's appellee's submission, para. 861.

<sup>767</sup>*Ibid.*, paras. 863-865.

<sup>768</sup>Panel Report, para. 7.1082.

<sup>769</sup>*Ibid.*, para. 7.1023; United States' appellant's submission, paras. 434-436.

530. Article 3.1(b) of the *SCM Agreement* provides:

*Article 3*

*Prohibition*

Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

- (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

We note that the introductory language of the chapeau makes it clear that the *Agreement on Agriculture* prevails over Article 3 of the *SCM Agreement*, but only to the extent that the former contains an exception.

531. Article 21.1 of the *Agreement on Agriculture*, which deals more broadly with the relationship between that Agreement and the other covered agreements relating to the trade in goods, provides:

The provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this Agreement.<sup>770</sup>

532. We agree that Article 21.1 could apply in the three situations described by the Panel, namely:

... where, for example, the domestic support provisions of the *Agreement on Agriculture* would prevail in the event that an explicit carve-out or exemption from the disciplines in Article 3.1(b) of the *SCM Agreement* existed in the text of the *Agreement on Agriculture*. Another situation would be where it would be impossible for a Member to comply with its domestic support obligations under the *Agreement on Agriculture* and the Article 3.1(b) prohibition simultaneously. Another situation might be where there is an explicit authorization in the text of the *Agreement on Agriculture* that would authorize a measure that, in the absence of such an express authorization, would be prohibited by Article 3.1(b) of the *SCM Agreement*.<sup>771</sup>

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<sup>770</sup>The *SCM Agreement* is among the Multilateral Trade Agreements in Annex 1A to the *WTO Agreement*.

<sup>771</sup>Panel Report, para. 7.1038. (original emphasis) The Panel concluded that "none of the situations just mentioned arise[s] in this dispute from the relevant provisions in the *Agreement on Agriculture*". (Panel Report, para. 7.1039)

The Appellate Body has interpreted Article 21.1 to mean that the provisions of the GATT 1994 and of other Multilateral Trade Agreements in Annex 1A apply, "except to the extent that the *Agreement on Agriculture* contains specific provisions dealing specifically with the same matter".<sup>772</sup> There could be, therefore, situations other than those identified by the Panel where Article 21.1 of the *Agreement on Agriculture* may be applicable.

533. The key issue before us is whether the *Agreement on Agriculture* contains "specific provisions dealing specifically with the same matter" as Article 3.1(b) of the *SCM Agreement*, that is, subsidies contingent upon the use of domestic over imported goods. We, therefore, turn to the relevant provisions of the *Agreement on Agriculture*.

534. The United States draws our attention to the domestic support provisions in the *Agreement on Agriculture*, particularly to Article 6.3 and to paragraph 7 of Annex 3. Article 6 of the *Agreement on Agriculture* deals with domestic support commitments. Pursuant to Article 6, WTO Members have committed themselves to reduce the domestic support that they provide to their agricultural sector.<sup>773</sup> For this purpose, domestic support is calculated using what is known as the AMS, which is defined in Article 1(a) as:

... the annual level of support, expressed in monetary terms, provided for an agricultural product in favour of the producers of the basic agricultural product or non-product-specific support provided in favour of agricultural producers in general, other than support provided under programmes that qualify as exempt from reduction under Annex 2 to this Agreement ...

A WTO Member's domestic support reduction commitments are registered in Part IV of its Schedule.

535. Article 6.3 of the *Agreement on Agriculture*, the particular provision relied on by the United States, reads:

A Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule.

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<sup>772</sup>Appellate Body Report, *EC – Bananas III*, para. 155. (See also Appellate Body Report, *Chile – Price Band System*, para. 186)

<sup>773</sup>Certain domestic measures are exempted from these reduction commitments under Articles 6.4 and 6.5 and Annex 2 of the *Agreement on Agriculture*.

The United States also relies on paragraph 7 of Annex 3 of the *Agreement on Agriculture*. This Annex explains how WTO Members are to calculate AMS. Paragraph 7 of Annex 3 states, in relevant part, that "[m]easures directed at agricultural processors shall be included [in the AMS calculation] to the extent that such measures benefit the producers of the basic agricultural products".

536. Before determining whether Article 6.3 and paragraph 7 of Annex 3 of the *Agreement on Agriculture* deal specifically with the same matter as Article 3.1(b) of the *SCM Agreement*, we must address the question whether the Step 2 payments to domestic users of United States upland cotton fall within paragraph 7 of Annex 3 because the United States claims that they are "[m]easures directed at agricultural processors" and "benefit the producers of the basic agricultural products". The United States argues that Step 2 payments to domestic users fall within paragraph 7 of Annex 3 because, even though the payment is provided to persons opening a bale of cotton, the payment *benefits* producers of United States cotton. The United States explains that this is the case "because [the program] serves to maintain the price competitiveness of U.S. cotton vis-a-vis foreign cotton through a payment to capture some differential between prevailing foreign and domestic cotton prices."<sup>774</sup>

537. We recall that "domestic users" are defined, under the United States' regulations, as "person[s] regularly engaged in the business of opening bales of eligible upland cotton for the purpose of manufacturing such cotton into cotton products in the United States".<sup>775</sup> The United States has acknowledged that the domestic users of United States cotton that receive Step 2 payments include textile mills.<sup>776</sup> There is no dispute between the parties that the producers of United States cotton are "producers of ... basic agricultural products" for purposes of paragraph 7 of Annex 3. Moreover, Brazil has not disputed the United States' claim that Step 2 payments to domestic users may "benefit" the producers of United States cotton. Therefore, we will proceed with our examination on the *assumption* that Step 2 payments to domestic users of United States cotton are contemplated by paragraph 7 of Annex 3 of the *Agreement on Agriculture*.<sup>777</sup>

538. We thus turn to the issue raised by the United States' appeal, that is, whether Article 6.3 and paragraph 7 of Annex 3 of the *Agreement on Agriculture* are "specific provisions dealing specifically with the same matter" as Article 3.1(b) of the *SCM Agreement*, namely, subsidies contingent upon the use of domestic over imported goods.

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<sup>774</sup>United States' appellant's submission, para. 428.

<sup>775</sup>See *supra*, para. 514.

<sup>776</sup>United States' response to questioning at oral hearing.

<sup>777</sup>In this dispute we do not decide whether subsidies paid to textile manufacturers on their purchases of cotton could be regarded as measures directed at "agricultural processors" within the meaning of paragraph 7 of Annex 3.

539. The United States finds in the second sentence of paragraph 7 of Annex 3 of the *Agreement on Agriculture* an exception to the broad prohibition against subsidies contingent upon the use of domestic over imported goods that is established in Article 3.1(b) of the *SCM Agreement*. We note that Annex 3 sets out instructions on how to calculate WTO Members' AMS. Paragraph 7 is one of 13 paragraphs contained in Annex 3. It reads:

The AMS shall be calculated as close as practicable to the point of first sale of the basic agricultural product concerned. Measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products.

540. Neither of the two sentences in paragraph 7 of Annex 3 refers to import substitution subsidies. Paragraph 7 of Annex 3 reflects a preference for calculating domestic support as near as possible to the stage of production of an agricultural good. Hence, the first sentence of paragraph 7 of Annex 3 provides that "[t]he AMS shall be calculated as close as practicable to the point of first sale of the basic agricultural product concerned". The second sentence of paragraph 7 recognizes situations where subsidies are not provided directly to the agricultural producer, but rather to an agricultural processor, yet the measures may benefit the producers of the basic agricultural good. This sentence also clarifies that only the portion of the subsidy that benefits the producers of the basic agricultural good, and not the entire amount, shall be included in a Member's AMS.

541. It may well be that a measure that is an import substitution subsidy could fall within the second sentence of paragraph 7 as "[m]easures directed at agricultural processors [that] shall be included [in the AMS calculation] to the extent that such measures benefit the producers of the basic agricultural products". There is nothing, however, in the text of paragraph 7 that suggests that such measures, when they are import substitution subsidies, are exempt from the prohibition in Article 3.1(b) of the *SCM Agreement*. We agree with the Panel that there is a clear distinction between a provision that requires a Member to include a certain type of payment (or part thereof) in its AMS calculation and one that would authorize subsidies that are contingent on the use of domestic over imported goods.<sup>778</sup>

542. The United States argues that, if payments to processors that fall within paragraph 7 are not exempted from the prohibition in Article 3.1(b) of the *SCM Agreement*, paragraph 7 would be rendered inutile.<sup>779</sup> According to the United States, if domestic users were allowed to claim Step 2 payments, regardless of the origin of the cotton, this "would cause the benefit to [domestic] cotton

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<sup>778</sup>Panel Report, para. 7.1059.

<sup>779</sup>United States' appellant's submission, para. 428.

producers to evaporate" and the "subsidy would be transformed from a subsidy 'in favor of agricultural producers' to a simple input subsidy".<sup>780</sup> Rather than "a cotton subsidy", it would become a "textile subsidy".<sup>781</sup> Like the Panel, we do not believe that the scope of paragraph 7 is limited to measures that have an import substitution component in them. There could be other measures covered by paragraph 7 of Annex 3 that do not necessarily have such a component. Indeed, Brazil submits that if the Step 2 payments were provided to United States processors of cotton, regardless of the origin of the cotton, these processors "would still buy *at least* some U.S. upland cotton, so producers would continue to derive *some* benefit".<sup>782</sup> Thus, paragraph 7 of Annex 3 refers more broadly to measures directed at agricultural processors that benefit producers of a basic agricultural product and, contrary to the United States' assertion, it is not rendered inutile by the Panel's interpretation. WTO Members may still provide subsidies directed at agricultural processors that benefit producers of a basic agricultural commodity in accordance with the *Agreement on Agriculture*, as long as such subsidies do not include an import substitution component.

543. In addition to paragraph 7 of Annex 3, the United States draws our attention to Article 6.3 of the *Agreement on Agriculture*. The United States points out that Article 6.3 explicitly provides that a WTO Member "shall be considered to be *in compliance* with its domestic support reduction commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of Current Total AMS does not exceed the corresponding annual or final bound commitment level". (emphasis added)

544. Like paragraph 7 of Annex 3, Article 6.3 does not explicitly refer to import substitution subsidies. Article 6.3 deals with domestic support. It establishes only a *quantitative* limitation on the amount of domestic support that a WTO Member can provide in a given year. The quantitative limitation in Article 6.3 applies generally to all domestic support measures that are included in a WTO Member's AMS. Article 3.1(b) of the *SCM Agreement* prohibits subsidies that are contingent—that is, "conditional"<sup>783</sup>—on the use of domestic over imported goods.<sup>784</sup>

545. Article 6.3 does not authorize subsidies that are contingent on the use of domestic over imported goods. It only provides that a WTO Member shall be considered to be in compliance with its domestic support *reduction commitments* if its Current Total AMS does not exceed that Member's

<sup>780</sup>United States' appellant's submission, para. 428.

<sup>781</sup>*Ibid.* (emphasis omitted)

<sup>782</sup>Brazil's appellee's submission, footnote 1242 to para. 854. (original emphasis)

<sup>783</sup>Appellate Body Report, *Canada – Autos*, para. 123.

<sup>784</sup>See Panel Report, para. 7.1067.

annual or final bound commitment level specified in its Schedule. It does not say that compliance with Article 6.3 of the *Agreement on Agriculture* insulates the subsidy from the prohibition in Article 3.1(b). We, therefore, agree with the Panel that:

Article 6.3 does *not* provide that compliance with such "domestic support reduction commitments" shall necessarily be considered to be in compliance with other applicable WTO obligations. Nor does it contain an explicit textual indication that otherwise prohibited measures are necessarily justified by virtue of compliance with the domestic support reduction commitments.<sup>785</sup>

546. For these reasons, we find that paragraph 7 of Annex 3 and Article 6.3 of the *Agreement on Agriculture* do not deal specifically with the same matter as Article 3.1(b) of the *SCM Agreement*, that is, subsidies contingent upon the use of domestic over imported goods.

547. We are mindful that the introductory language of Article 3.1 of the *SCM Agreement* clarifies that this provision applies "[e]xcept as provided in the Agreement on Agriculture". Furthermore, as the United States has pointed out, this introductory language applies to both the export subsidy prohibition in paragraph (a) and to the prohibition on import substitution subsidies in paragraph (b) of Article 3.1. As we explained previously, in our review of the provisions of the *Agreement on Agriculture* relied on by the United States, we did not find a provision that deals specifically with subsidies that have an import substitution component. By contrast, the prohibition on the provision of subsidies contingent upon the use of domestic over imported goods in Article 3.1(b) of the *SCM Agreement* is explicit and clear. Because Article 3.1(b) treats subsidies contingent on the use of domestic over imported products as prohibited subsidies, it would be expected that the drafters would have included an equally explicit and clear provision in the *Agreement on Agriculture* if they had indeed intended to authorize such prohibited subsidies provided in connection with agricultural goods. We find no provision in the *Agreement on Agriculture* dealing specifically with subsidies contingent upon the use of domestic over imported agricultural goods.

548. Our approach in this case is consistent with the Appellate Body's approach in *EC – Bananas III*. In that case, the European Communities relied on Article 4.1 of the *Agreement on Agriculture* in arguing that the market access concessions it made for agricultural products pursuant to the *Agreement on Agriculture* prevailed over Article XIII of the GATT 1994.<sup>786</sup> The Appellate Body, however, found that "[t]here is nothing in Articles 4.1 or 4.2, or in any other article of the *Agreement on Agriculture*, that deals specifically with the allocation of tariff quotas on agricultural

<sup>785</sup>Panel Report, para. 7.1058. (original emphasis)

<sup>786</sup>Appellate Body Report, *EC – Bananas III*, para. 153.

products".<sup>787</sup> It further explained that "[i]f the negotiators had intended to permit Members to act inconsistently with Article XIII of the GATT 1994, they would have said so explicitly".<sup>788</sup> The situation before us is similar. We have found nothing in Article 6.3, paragraph 7 of Annex 3 or anywhere else in the *Agreement on Agriculture* that "deals specifically" with subsidies that are contingent on the use of domestic over imported agricultural products.

549. We recall that the *Agreement on Agriculture* and the *SCM Agreement* "are both Multilateral Agreements on Trade in Goods contained in Annex 1A of the *Marrakesh Agreement Establishing the World Trade Organization* (the "*WTO Agreement*"), and, as such, are both 'integral parts' of the same treaty, the *WTO Agreement*, that are 'binding on all Members'".<sup>789</sup> Furthermore, as the Appellate Body has explained, "a treaty interpreter must read all applicable provisions of a treaty in a way that gives meaning to all of them, harmoniously".<sup>790</sup> We agree with the Panel that "Article 3.1(b) of the *SCM Agreement* can be read together with the *Agreement on Agriculture* provisions relating to domestic support in a coherent and consistent manner which gives full and effective meaning to all of their terms".<sup>791</sup>

550. In sum, we are not persuaded by the United States' submission that the prohibition in Article 3.1(b) of the *SCM Agreement* is inapplicable to import substitution subsidies provided in connection with products falling under the *Agreement on Agriculture*. WTO Members may still provide domestic support that is consistent with their reduction commitments under the *Agreement on Agriculture*. In providing such domestic support, however, WTO Members must be mindful of their other WTO obligations, including the prohibition in Article 3.1(b) of the *SCM Agreement* on the provision of subsidies that are contingent on the use of domestic over imported goods.

551. Turning to the particular measure before us in this dispute, we recall that the United States acknowledged before the Panel that, if the *SCM Agreement* were applicable, "user marketing (Step 2) payments to domestic users [would] constitute a subsidy conditional or dependent upon the

<sup>787</sup> Appellate Body Report, *EC – Bananas III*, para. 157.

<sup>788</sup> *Ibid.*

<sup>789</sup> Appellate Body Report, *Argentina – Footwear (EC)*, para. 81 (quoting from *WTO Agreement*, Article II:2). (original emphasis) In that case, the Appellate Body was referring to the GATT 1994 and the *Agreement on Safeguards*.

<sup>790</sup> Appellate Body, *Argentina – Footwear (EC)*, para. 81 and footnote 72 thereto (referring to Appellate Body Report, *Korea – Dairy*, para. 81; Appellate Body Report, *US – Gasoline*, p. 23, DSR 1996:1, 3 at 21; Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 12, DSR 1996:1, 97 at 106; and Appellate Body Report, *India – Patents (US)*, para. 45). (original emphasis)

<sup>791</sup> Panel Report, para. 7.1071.

use of domestic over imported goods within the meaning of Article 3.1(b)" of that Agreement.<sup>792</sup> The Panel also conducted its own analysis and concluded that:

The use of United States domestically produced upland cotton is a condition for obtaining the subsidy. User marketing (Step 2) payments to domestic users under section 1207(a) of the FSRI Act of 2002 are clearly conditional, or dependent upon, such use.<sup>793</sup>

The United States has not appealed this finding and, therefore, we need not review it.

552. Accordingly, we uphold the Panel's findings, in paragraphs 7.1088, 7.1097-7.1098 and 8.1(f) of the Panel Report, that Step 2 payments to domestic users of United States upland cotton, under Section 1207(a) of the FSRI Act of 2002, are subsidies contingent on the use of domestic over imported goods that are inconsistent with Articles 3.1(b) and 3.2 of the *SCM Agreement*.

B. *Step 2 Payments to Exporters*

553. We turn to the United States' claim that the Panel erred in finding that Step 2 payments provided to exporters of United States upland cotton, under Section 1207(a) of the FSRI Act of 2002, are subsidies contingent on exportation and, therefore, are inconsistent with Articles 3.3 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement*. We described the Step 2 payments program in the previous Section of this Report, where we examined the Panel's findings relating to Step 2 payments provided to domestic users of United States upland cotton.<sup>794</sup>

554. Before the Panel, Brazil argued that Step 2 payments to exporters are *per se* export subsidies listed in Article 9.1(a) of the *Agreement on Agriculture* and are inconsistent with Article 3.3 and/or Article 8 of the *Agreement on Agriculture*, as well as with Articles 3.1 and 3.2 of the *SCM Agreement*.<sup>795</sup> The United States denied that Step 2 payments constitute export subsidies for purposes of the *Agreement on Agriculture* or Articles 3.1(a) and 3.2 of the *SCM Agreement*, arguing that these payments are available not only to exporters, but also to domestic users of upland cotton.<sup>796</sup>

<sup>792</sup> Panel Report, para. 7.1082.

<sup>793</sup> *Ibid.*, para. 7.1086.

<sup>794</sup> See also *ibid.*, paras. 7.209-7.211.

<sup>795</sup> *Ibid.*, para. 7.649(i). Brazil also made an alternative claim under Article 10.1 of the *Agreement on Agriculture*, but the Panel found it unnecessary to examine this claim because of its findings under Article 9. (*Ibid.*, para. 7.750)

<sup>796</sup> *Ibid.*, para. 7.651(i).

555. Because Brazil challenged the alleged United States export subsidies under the *Agreement on Agriculture* and the *SCM Agreement*, the Panel first examined the relationship between these Agreements. The Panel explained what it considered to be the proper order of analysis as follows:

... it is appropriate to examine an alleged export subsidy in respect of an agricultural product first under the *Agreement on Agriculture* before, if and as appropriate, turning to any examination of the same measure under the *SCM Agreement*.<sup>797</sup>

556. Accordingly, the Panel began its examination of Brazil's claims against the Step 2 payments to exporters with Article 9.1 of the *Agreement on Agriculture*. In this respect, the Panel observed that the United States did not appear to dispute that Step 2 payments are subsidies provided by a government to producers of agricultural products, or to cooperatives or associations of such producers for purposes of Article 9.1(a) of the *Agreement on Agriculture*.<sup>798</sup> The "key issue" before it, the Panel explained, was whether Step 2 payments to exporters are subsidies "contingent on export performance" within the meaning of Article 9.1(a) of the *Agreement on Agriculture*.<sup>799</sup>

557. The Panel then noted that the *Agreement on Agriculture* does not define the phrase "contingent on export performance". Given that a similar phrase is used in the *SCM Agreement*, the Panel saw no reason to read the phrase differently in the *Agreement on Agriculture*.<sup>800</sup> The Panel also equated Brazil's claim that Step 2 payments to exporters are "per se" export subsidies with a claim that the subsidies are *de jure* export contingent under Article 3.1(a) of the *SCM Agreement*.<sup>801</sup> Such a claim of *de jure* export contingency had to be demonstrated, according to the Panel, "on the basis of the words of the relevant legislation, regulation or other legal instrument"<sup>802</sup> or "where the condition to export can be derived by necessary implication from the words actually used in the measure".<sup>803</sup>

<sup>797</sup> Panel Report, para. 7.673. The order of analysis was not an issue on appeal.

<sup>798</sup> *Ibid.*, para. 7.695. The Panel also conducted its own assessment and concluded that the measure meets the description in Article 9.1(a). (*Ibid.*, para. 7.696)

<sup>799</sup> *Ibid.*, para. 7.697.

<sup>800</sup> *Ibid.*, para. 7.700 and footnote 872 thereto (relying on Appellate Body Report, *US – FSC*, para. 141 and Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 192).

<sup>801</sup> *Ibid.*, para. 7.702.

<sup>802</sup> *Ibid.*, (relying on Appellate Body Report, *Canada – Aircraft*, para. 167).

<sup>803</sup> *Ibid.*, para. 7.702 (relying on Appellate Body Report, *Canada – Autos*, para. 100 and Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 112).

558. In assessing whether the Step 2 payments to exporters are contingent on export performance under Article 9.1(a) of the *Agreement on Agriculture*, the Panel found:

It is undeniable that a condition of the receipt of user marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 will always and inevitably be proof of exportation. The only way to receive such a payment is through exportation. Export performance is, therefore, a condition of receipt for this discrete segment of eligible recipients.

Every user marketing (Step 2) payment to an eligible exporter is contingent upon export.<sup>804</sup>

559. The Panel rejected the United States' contention that Step 2 payments are not contingent on export performance because they are available to both exporters and domestic users. According to the Panel, the program under which Step 2 payments are granted "involves payment to two distinct sets of recipients (exporters or domestic users) in two distinct factual situations (export or domestic use)".<sup>805</sup> In the Panel's view, "[t]he fact that the subsidies granted in the second situation may not be export contingent does not dissolve the export contingency arising in the first situation".<sup>806</sup>

560. Having found that Step 2 payments to exporters are mandatory when certain market conditions exist<sup>807</sup>, the Panel concluded:

We therefore find that section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters constitutes a subsidy "contingent on export performance" within the meaning of Article 9.1(a) of the *Agreement on Agriculture*.<sup>808</sup>

<sup>804</sup> Panel Report, paras. 7.734 and 7.735.

<sup>805</sup> *Ibid.*, para. 7.732.

<sup>806</sup> *Ibid.*, para. 7.739 and footnote 907 thereto (relying on Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 119).

<sup>807</sup> *Ibid.*, paras. 7.7745 and 7.746.

<sup>808</sup> *Ibid.*, para. 7.748.

561. Consequently, the Panel also found:

User marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 are an export subsidy listed in Article 9.1 of the *Agreement on Agriculture*. In providing such subsidies, the United States has acted inconsistently with its obligation under Article 3.3 of the *Agreement on Agriculture* to "not provide subsidies in respect of any agricultural product not specified in ... its Schedule". The United States has furthermore acted inconsistently with its obligation in Article 8 of the *Agreement on Agriculture* "not to provide export subsidies otherwise than in conformity with [the *Agreement on Agriculture*] and with the commitments as specified in [its] Schedule".<sup>809</sup>

562. As for Brazil's claims under the *SCM Agreement*, the Panel found "that section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters is inconsistent with Article 3.1(a) of the *SCM Agreement*".<sup>810</sup> The Panel additionally found that "[t]o the extent that section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters is inconsistent with Article 3.1(a), it is, consequently, also inconsistent with Article 3.2 of the *SCM Agreement*".<sup>811</sup>

563. On appeal, the United States requests us to reverse the Panel's findings that Step 2 payments provided to exporters of United States upland cotton are export subsidies within the meaning of Article 9.1(a) of the *Agreement on Agriculture* and, therefore, are inconsistent with Articles 3.3 and 8 of that Agreement. The United States also requests that we reverse the Panel's finding that Step 2 payments to exporters are inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*, because they are not exempted from action by Article 13(c) of the *Agreement on Agriculture*.<sup>812</sup>

564. The United States does not contest that Step 2 payments are subsidies to producers of an agricultural product for purposes of Article 9.1(a) of the *Agreement on Agriculture*; nor does it contest the Panel's finding in this regard. The focus of the United States' appeal is the Panel's finding that Step 2 payments are contingent on export performance under Article 9.1(a).<sup>813</sup> In support of its claim, the United States reiterates on appeal the arguments that it made before the Panel. The United States asserts that Step 2 payments are not contingent on export performance because Step 2 payments

<sup>809</sup>Panel Report, para. 7.749.

<sup>810</sup>*Ibid.*, para. 7.760.

<sup>811</sup>*Ibid.*, para. 7.761.

<sup>812</sup>United States' appellant's submission, para. 516(6).

<sup>813</sup>*Ibid.*, para. 442.

are also available to domestic users of United States upland cotton.<sup>814</sup> The United States contends that the payments are contingent on use, not exportation.

565. Brazil requests that we uphold the Panel's finding that Step 2 payments to exporters are contingent upon export performance.<sup>815</sup> According to Brazil, the measure pursuant to which Step 2 payments are granted establishes two mutually exclusive conditions of payment that address two different factual situations where a Step 2 payment can be made.<sup>816</sup> These situations are mutually exclusive because the same bale of cotton cannot be both opened for domestic use and exported.<sup>817</sup> In one situation under the Step 2 measure, proof of exportation is required as a condition of payment. This export contingency is not dissolved because the payment can also be made in another situation to domestic users, on other conditions.<sup>818</sup>

566. In addition, Brazil rejects the United States' contention that Step 2 payments are contingent on use and not on exportation. Brazil explains that Step 2 payments do not apply to all United States production of upland cotton because domestic brokers, resellers and other persons not regularly engaged in opening bales of cotton for manufacturing are not eligible to receive the payments.<sup>819</sup> Furthermore, Brazil asserts that, in the case of Step 2 payments to exporters, the payment is not contingent on use because the measure is indifferent to whether, how or when the upland cotton is used so long as it is exported.<sup>820</sup>

567. The issue raised on appeal is whether the Step 2 payments provided to exporters of United States upland cotton, under Section 1207(a) of the FSRI Act of 2002, are contingent on export performance within the meaning of Article 9.1(a) of the *Agreement on Agriculture* and Article 3.1(a) of the *SCM Agreement*.

<sup>814</sup>United States' appellant's submission, para. 443. The United States submits that its position is consistent with the reasoning of the panel in *Canada – Dairy*. (*Ibid.*, para. 444 (relying on Panel Report, *Canada – Dairy*, para. 7.41))

<sup>815</sup>Brazil's appellee's submission, para. 872.

<sup>816</sup>*Ibid.*, para. 888.

<sup>817</sup>*Ibid.*

<sup>818</sup>Brazil finds support for its argument in the Appellate Body's reasoning in *US – FSC (Article 21.5 – EC)*. See *supra*, footnote 806. (Brazil's appellee's submission, paras. 883-884)

<sup>819</sup>Brazil's appellee's submission, para. 886.

<sup>820</sup>*Ibid.*, para. 891.

568. Article 9.1(a) of the *Agreement on Agriculture* reads :

[T]he provision by governments or their agencies of direct subsidies, including payments-in-kind, to a firm, to an industry, to producers of an agricultural product, to a cooperative or other association of such producers, or to a marketing board, contingent on export performance[.]

569. Article 3.1(a) of the *SCM Agreement* provides:

*Article 3*  
*Prohibition*

Except as provided in the *Agreement on Agriculture*, the following subsidies, within the meaning of Article 1, shall be prohibited:

- (a) subsidies contingent, in law or in fact<sup>4</sup>, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I<sup>5</sup>;

<sup>4</sup> This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.

<sup>5</sup> Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this *Agreement*.

570. In previous appeals, the Appellate Body has explained that the WTO-consistency of an export subsidy for agricultural products has to be examined, in the first place, under the *Agreement on Agriculture*<sup>821</sup>; the examination under the *SCM Agreement* would follow if necessary. Turning, then, to the *Agreement on Agriculture*, we note that Article 1(e) of that *Agreement* defines "export subsidies" as "subsidies contingent upon export performance, including the export subsidies listed in Article 9 of this *Agreement*".

571. Although an export subsidy granted to agricultural products must be examined, in the first place, under the *Agreement on Agriculture*, we find it appropriate, as has the Appellate Body in previous disputes, to rely on the *SCM Agreement* for guidance in interpreting provisions of the *Agreement on Agriculture*. Thus, we consider the export-contingency requirement in Article 1(e) of

<sup>821</sup>See, for example, Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 123.

the *Agreement on Agriculture* having regard to that same requirement contained in Article 3.1(a) of the *SCM Agreement*.<sup>822</sup>

572. The Appellate Body has indicated, in this regard, that the ordinary meaning of "contingent" is "conditional" or "dependent"<sup>823</sup> and that Article 3.1(a) of the *SCM Agreement* prohibits subsidies that are conditional upon export performance, or are dependent for their existence on export performance.<sup>824</sup> It has also emphasized that "a relationship of conditionality or dependence", namely that the granting of a subsidy should be 'tied to' the export performance, lies at the 'very heart' of the legal standard in Article 3.1(a) of the *SCM Agreement*.<sup>825</sup> We are also mindful that in demonstrating export contingency in the case of subsidies that are contingent in law upon export performance, the "existence of that condition can be demonstrated on the basis of the very words of the relevant legislation, regulation or other legal instrument constituting the measure".<sup>826</sup>

573. It is clear that the legal provisions pursuant to which Step 2 payments are granted to exporters of United States upland cotton, on their face, apply to exporters of United States upland cotton. Section 1207(a) of the FSRI Act of 2002 provides that, when certain market conditions exist, the United States Secretary of Agriculture:

... shall issue marketing certificates or cash payments, at the option of the recipient, to domestic users and *exporters* for documented purchases by domestic users and *sales for export by exporters*. (emphasis added)

The regulations define "eligible exporters" as:

A person, including a producer or a cooperative marketing association ... regularly engaged in selling eligible upland cotton for exportation from the United States (exporter), who has entered into an agreement with CCC[<sup>827</sup>] to participate in the upland cotton user marketing certificate program.<sup>828</sup>

<sup>822</sup>Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 192.

<sup>823</sup>Appellate Body Report, *Canada – Aircraft*, para. 166.

<sup>824</sup>Appellate Body Report, *Canada – Aircraft (Article 21.5 – Brazil)*, para. 47. See also Appellate Body Report, *Canada – Aircraft*, para. 166.

<sup>825</sup>Appellate Body Report, *Canada – Aircraft (Article 21.5 – Brazil)*, para. 47 (quoting Appellate Body Report, *Canada – Aircraft*, para. 171).

<sup>826</sup>The legal instrument does not have to provide expressly for the export contingency; the conditionality may be derived by necessary implication from the text of the measure. (Appellate Body Report, *Canada – Autos*, para. 100)

<sup>827</sup>Additional information about the CCC is provided, *infra*, footnote 859; see also Panel Report, para. 7.702.

<sup>828</sup>7 CFR Section 1427.104(a)(2).

"Eligible upland cotton" is defined as "domestically produced baled upland cotton which bale is opened by an eligible domestic user ... or exported by an eligible exporter."<sup>829</sup>

574. Furthermore, in order to claim Step 2 payments, exporters must submit an application and provide supporting documentation to the CCC, including "proof of export of eligible cotton by the exporter."<sup>830</sup> This provision confirms that the payment is "tied to" exportation. As the Panel explained, "a condition of the receipt of user marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 will always and inevitably be proof of exportation"<sup>831</sup>. Thus, on the face of the statute and regulations pursuant to which Step 2 payments are granted to exporters, the payments are "conditional upon export performance" or "dependent for their existence on export performance".<sup>832</sup>

575. The United States directed the Panel's attention to the fact that the same statute and regulations also provide for similar payments to domestic users conditioned on the domestic use of United States upland cotton. According to the United States, Step 2 payments to exporters and domestic users are governed by a single legislative provision and a single set of regulations. In addition, the form and payment rate to domestic users and exporters are identical, and the payments are made from a single fund.<sup>833</sup> As Step 2 payments are available to both domestic users and exporters, the United States submits that exportation is not a condition to receive payment and, therefore, the payments are not export-contingent.<sup>834</sup>

576. We are not persuaded by the United States' arguments. Like the Panel, we recognize that Step 2 payments to exporters and domestic users are governed by a single legislative provision and a single set of regulations, that the form and rate of payment to exporters and domestic users are identical, and that the fund from which payments are made is a single fund.<sup>835</sup> Nevertheless, we agree with the Panel that the statute and regulations pursuant to which Step 2 payments are granted do not establish a "single class" of recipients of the payments; rather, the statute and regulations clearly distinguish between two types of eligible recipients, namely, eligible exporters and eligible domestic users.<sup>836</sup> As we have seen, an eligible exporter must be "[a] person, including a producer or a

<sup>829</sup>7 CFR Section 1427.103(a). (emphasis added)

<sup>830</sup>7 CFR Section 1427.108(d).

<sup>831</sup>Panel Report, para. 7.734.

<sup>832</sup>See Appellate Body Report, *Canada – Aircraft (Article 21.5 – Brazil)*, para. 47.

<sup>833</sup>United States' appellant's submission, para. 442.

<sup>834</sup>*Ibid.*, para. 454.

<sup>835</sup>Panel Report, para. 7.709.

<sup>836</sup>*Ibid.*, paras. 7.721-7.723.

cooperative marketing association ... regularly engaged in selling eligible upland cotton for exportation from the United States".<sup>837</sup> In contrast, an "eligible domestic user" is "[a] person regularly engaged in the business of opening bales of eligible upland cotton for the purpose of manufacturing such cotton into cotton products in the United States".<sup>838</sup> Thus, the statute and regulations themselves clearly distinguish between exporters and domestic users.

577. In addition, the statute and regulations establish different conditions that eligible exporters and eligible domestic users must meet to receive Step 2 payments. An eligible domestic user must "open" a bale of cotton to qualify for payment.<sup>839</sup> For its part, an eligible exporter must demonstrate the upland cotton has been exported. These are distinct conditions that the statute and regulations themselves set out for the two distinct recipients of Step 2 payments. Because the conditions to qualify for payment are different, the documentation required from eligible domestic users and eligible exporters is also different. An eligible exporter must submit proof of exportation; an eligible domestic user must provide documentation indicating the number of bales opened.<sup>840</sup> We agree, therefore, with the Panel's view that the statute and regulations pursuant to which Step 2 payments are granted "involve[] payment to two distinct sets of recipients (exporters or domestic users) in two distinct factual situations (export or domestic use)".<sup>841</sup>

578. Furthermore, we agree with the Panel's conclusion that the fact that the subsidy is also available to domestic users of upland cotton does not "dissolve" the export-contingent nature of the Step 2 payments to exporters.<sup>842</sup> The Panel's reasoning is consistent with the approach taken by the Appellate Body in *US – FSC (Article 21.5 – EC)*.<sup>843</sup> In that case, the United States argued that the tax exclusion at issue was not an export-contingent subsidy because it was available for both (i) property produced within the United States and held for use outside the United States and (ii) property produced outside the United States and held for use outside the United States. The United States

<sup>837</sup>7 CFR Section 1427.104(a)(2). (emphasis added)

<sup>838</sup>7 CFR Section 1427.104(a)(1).

<sup>839</sup>United States' response to questioning at oral hearing. 7 CFR Section 1427.103(a).

<sup>840</sup>Panel Report, para. 7.727.

<sup>841</sup>*Ibid.*, para. 7.732.

<sup>842</sup>*Ibid.*, para. 7.739.

<sup>843</sup>The Panel also found support for its reasoning in the Appellate Body's statement, in *Canada – Aircraft*, that:

... the fact that some of TPC's contributions, in some industry sectors, are not contingent upon export performance, does not necessarily mean that the same is true for all of TPC's contributions. It is enough to show that one or some of TPC's contributions do constitute subsidies "contingent ... in fact ... upon export performance".

(Appellate Body Report, *Canada – Aircraft*, para. 179) (original emphasis)

asserted that, as the tax exemption was available in both circumstances, it was "export-neutral".<sup>844</sup> According to the United States, the panel's separate examination of each situation in which the tax exemption was available "artificially bifurcat[ed]" the measure.<sup>845</sup>

579. The Appellate Body rejected the United States' contention in *US – FSC (Article 21.5 – EC)* because it considered it necessary, under Article 3.1(a) of the *SCM Agreement*, "to examine separately the conditions pertaining to the grant of the subsidy in the two different situations".<sup>846</sup> It then confirmed the Panel's finding that the tax exemption in the first situation, namely for property produced within the United States and held for use outside the United States, is an export-contingent subsidy.<sup>847</sup> In its reasoning, the Appellate Body explained that whether or not the subsidies were export-contingent in both situations envisaged by the measure would not alter the conclusion that the tax exemption in the first situation was contingent upon export:

Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances. The fact that the subsidies granted in the second set of circumstances *might* not be export contingent does not dissolve the export contingency arising in the first set of circumstances. Conversely, the export contingency arising in these circumstances has no bearing on whether there is an export contingent subsidy in the second set of circumstances.<sup>848</sup>

580. As in *US – FSC (Article 21.5 – EC)*, the Panel in this case found that Step 2 payments are available in two situations, only one of which involves export contingency.<sup>849</sup> The Panel's conclusion, therefore, is consistent with the Appellate Body's holding in *US – FSC (Article 21.5 – EC)* quoted above that "the fact that the subsidies granted in the second set of circumstances *might* not be export contingent does not dissolve the export contingency arising in the first set of circumstances".

581. The United States submits that the facts in this case are similar to those before the panel in *Canada – Dairy*.<sup>850</sup> In that dispute, the complaining parties argued that the provision of milk to exporters/processors under various mechanisms (described as "special milk classes") constituted

<sup>844</sup>Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 110.

<sup>845</sup>*Ibid.*

<sup>846</sup>*Ibid.*, para. 115.

<sup>847</sup>*Ibid.*, para. 120.

<sup>848</sup>*Ibid.*, para. 119. (original emphasis; footnote omitted)

<sup>849</sup>See, *supra*, para. 577.

<sup>850</sup>United States' appellant's submission, paras. 444-445 (referring to Panel Report, *Canada – Dairy*, para. 7.41 and footnote 496 to para. 7.124).

export-contingent subsidies. The panel in *Canada – Dairy* found, nevertheless, that certain special milk classes were *not* export-contingent because the "milk under such other classes is also available (often exclusively) to processors which produce for the domestic market".<sup>851</sup> The Panel, in this dispute, did not see any relevance in the Panel Report in *Canada – Dairy* because, in that case, "there was no explicit condition limiting a discrete segment of the payments of the subsidies concerned to exporters".<sup>852</sup> Brazil also seeks to distinguish the factual situation in *Canada – Dairy*, explaining that it involved a single regulatory class of milk instead of two mutually exclusive regulatory categories, as is the case in the present dispute.<sup>853</sup> We agree with the Panel and Brazil that the facts in *Canada – Dairy* differ from those of the present dispute. In this case, we have before us a statute and regulations that clearly distinguish between two sets of recipients—that is, eligible exporters and eligible domestic users—that must meet different conditions to receive payment.<sup>854</sup> In the case of one set of recipients, eligible exporters, exportation is a necessary condition to receive payment.

582. In sum, we agree with the Panel's view that Step 2 payments are export-contingent and, therefore, an export subsidy for purposes of Article 9 of the *Agreement on Agriculture* and Article 3.1(a) of the *SCM Agreement*. The statute and regulations pursuant to which Step 2 payments are granted, on their face, condition payments to exporters on exportation.<sup>855</sup> In order to claim payment, an exporter must show proof of exportation. If an exporter does not provide proof of exportation, the exporter will not receive a payment. This is sufficient to establish that Step 2 payments to exporters of United States upland cotton are "conditional upon export performance" or "dependent for their existence on export performance".<sup>856</sup> That domestic users may also be eligible to receive payments under different conditions does not eliminate the fact that an exporter will receive payment only upon proof of exportation.

583. For these reasons, we *uphold* the Panel's findings, in paragraphs 7.748-7.749 and 8.1(e) of the Panel Report, that Step 2 payments to exporters of United States upland cotton, pursuant to Section 1207(a) of the FSRI Act of 2002, constitute subsidies contingent upon export performance within the meaning of Article 9.1(a) of the *Agreement on Agriculture* and that, therefore, in providing such subsidies the United States has acted inconsistently with its obligations under Articles 3.3 and 8 of the *Agreement on Agriculture*.

<sup>851</sup>Panel Report, *Canada – Dairy*, para. 7.41.

<sup>852</sup>Panel Report, para. 7.718.

<sup>853</sup>Brazil's appellee's submission, paras. 898-899.

<sup>854</sup>See *supra*, para. 577.

<sup>855</sup>Panel Report, para. 7.734.

584. Having explained that there is no reason to read the export-contingency requirement in the *Agreement on Agriculture* differently from that contained in Article 3.1(a) of the *SCM Agreement*<sup>857</sup>, and having found that Step 2 payments to exporters of United States upland cotton are contingent upon export performance within the meaning of Article 9.1 of the *Agreement on Agriculture*, we also find that such payments are export-contingent for purposes of Article 3.1(a) of the *SCM Agreement*.<sup>858</sup> Consequently, we uphold the Panel's findings, in paragraphs 7.760-7.761 and 8.1(e) of the Panel Report, that Step 2 payments provided to exporters of United States upland cotton, pursuant to Section 1207(a) of the FSRI Act of 2002, are inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*.

C. *Export Credit Guarantees – Article 10.2 of the Agreement on Agriculture*

585. We turn next to the United States' and Brazil' appeals of the Panel's findings relating to the United States' export credit guarantee programs.

1. United States' Export Credit Guarantee Programs

586. Brazil challenges three types of export credit guarantee programs. The first two programs, GSM 102 and GSM 103, provide guarantees to exporters when credit is extended by foreign financial institutions. The third type, the SCGP, applies when credit is extended by the exporter to the purchaser of United States agricultural products.<sup>859</sup>

587. The GSM 102 program is available to cover commercial exports of United States agricultural commodities on credit terms of between 90 days and 3 years. To obtain the credit guarantee under GSM 102, the exporter must have received a letter of credit in its favour from the foreign bank and must apply for the guarantee before making the exportation. The exporter will pay a fee for the

<sup>856</sup>See Appellate Body Report, *Canada – Aircraft (Article 21.5 – Brazil)*, para. 47.

<sup>857</sup>See *supra*, para. 571.

<sup>858</sup>As the Panel observed, pursuant to Article 13(c)(ii) of the *Agreement on Agriculture*, "to the extent that the export subsidy at issue does not conform fully to the provisions of Part V of the *Agreement on Agriculture*, it is not exempt from actions based on Articles 3.1(a) and 3.2 of the *SCM Agreement*". (Panel Report, para. 7.751)

<sup>859</sup>These export credit guarantee programs are established under Section 5622 of Title 7 of the United States Code and implemented in Part 1493 of Title 7 of the United States Code of Federal Regulations. (See Panel Report, para. 7.250(vi)) Subpart B of Part 1493 relates to the GSM 102 and the GSM 103 programs and Subpart D deals with the SCGP program. GSM 102 and 103 export credit guarantees have been issued since late 1980, while the SCGP program began in 1996. (United States' first written submission to the Panel, paras. 151 and 152 and footnote 133 thereto) Export credit guarantee programs are administered through the CCC, created under the Commodity Credit Corporation Charter Act of 1948. The CCC is a federal corporation established within the USDA. (Panel Report, para. 7.236 and footnote 346 thereto) A further description of the GSM 102, GSM 103 and SCGP is provided in Panel Report, paras. 7.236-7.244.

guarantee based on a schedule of rates that vary according to the credit period, but are capped by law at one per cent of the guaranteed dollar value of the transaction. In the event that the foreign bank fails to make a payment, the exporter informs the CCC of the default and "[t]he CCC generally covers 98 per cent of the principal and a portion of the interest".<sup>860</sup>

588. The GSM 103 is similar to the GSM 102. The difference between the two programs is that GSM 103 guarantees export credits that have longer terms. Specifically, GSM 103 guarantees credits with terms of between 3 and 10 years. An additional difference is that, contrary to GSM 102, the fee that an exporter must pay to obtain a guarantee under GSM 103 is not capped by law.

589. The SCGP guarantees credits extended by the exporter itself to foreign buyers of United States agricultural commodities. Under the SCGP, the United States exporter is required to submit to the CCC a promissory note signed by the importer prior to exportation. The exporter will pay a fee at a rate that varies according to the term of the loan, and, like GSM 102, is capped by law at one per cent of the guaranteed dollar value of the transaction. If the importer defaults on the promissory note, then the CCC will pay the exporter 65 per cent of the dollar value of the exported product (excluding interest).

2. Panel Findings

590. Before the Panel, Brazil asserted that these three United States export credit guarantee programs—GSM 102, GSM 103 and SCGP—violate Articles 10.1 and 8 of the *Agreement on Agriculture* and are therefore not exempt, under Article 13(c)(ii) of the *Agreement on Agriculture*, from actions based on Articles 3.1(a) and 3.2 of the *SCM Agreement*.<sup>861</sup> Brazil also argued that the three programs violate Articles 3.1(a) and 3.2 of the *SCM Agreement*.<sup>862</sup>

591. The United States responded that Article 10.2 of the *Agreement on Agriculture* makes it clear that the export subsidy disciplines in the *Agreement on Agriculture* and the *SCM Agreement* are not applicable to export credit guarantee programs. According to the United States, Article 10.2 of the *Agreement on Agriculture* "reflects the deferral of disciplines on export credit guarantee programs contemplated by WTO Members".<sup>863</sup> The United States argued that, even if the export subsidy disciplines in the *SCM Agreement* were applicable, its export credit guarantee programs are not prohibited export subsidies under Article 3.1(a) because they do not meet the criteria in item (j) of

<sup>860</sup>Panel Report, para. 7.242.

<sup>861</sup>Panel Report, para. 7.765.

<sup>862</sup>*Ibid.*, para. 7.765.

<sup>863</sup>United States' first written submission to the Panel, para. 160 (quoted in Panel Report, para. 7.770).

the Illustrative List of Export Subsidies attached to the *SCM Agreement* as Annex I, namely that the premiums are inadequate to cover the programs' long-term operating costs and losses.<sup>864</sup>

592. At the outset of its analysis, the Panel observed that it would adopt the parties' shared view that "export credit guarantees are not included in the non-exhaustive list of export subsidies in Article 9.1, and that Article 10 of the *Agreement on Agriculture* is the relevant provision".<sup>865</sup> The Panel then stated that Article 10.1 "covers any subsidy contingent on export performance that is not listed in Article 9.1".<sup>866</sup> The Panel observed that, other than the list of export subsidies listed in Article 9.1, the *Agreement on Agriculture* does not specify what is a subsidy contingent upon export performance.<sup>867</sup> Thus, the Panel sought contextual guidance in the *SCM Agreement*, to assist it in its interpretation of the term "export subsidies" in Article 10.1 of the *Agreement on Agriculture*. In particular, the Panel looked at item (j) of the Illustrative List of Export Subsidies annexed to the *SCM Agreement*, observing that "there is no disagreement between the parties ... that, if an export credit guarantee programme meets the elements of item (j), it is a *per se* export subsidy".<sup>868</sup>

593. The Panel then examined whether the United States' export credit guarantee programs challenged by Brazil met the criteria set out in item (j) and concluded that:

On the basis of the totality of the record evidence, including approaches regularly relied upon by the United States government itself, we find that Brazil has established that the United States CCC provides the GSM 102, GSM 103 and SCGP export credit guarantee programmes "at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes" within the meaning of item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*.<sup>869</sup>

594. Having reached this general conclusion, the Panel next examined Brazil's claims that the United States' export credit guarantees "result[ ] in" or "threaten[ ] to lead to" circumvention of the United States' export subsidy commitments, contrary to Article 10.1 of the *Agreement on Agriculture*. In its analysis, the Panel distinguished between, on the one hand, "supported" and "unsupported" products, and, on the other, "scheduled" and "unscheduled" products. The Panel used the term "supported products" to refer to products for which there was evidence in the record showing that they

<sup>864</sup>Panel Report, para. 7.772.

<sup>865</sup>*Ibid.*, para. 7.788.

<sup>866</sup>*Ibid.*, para. 7.796.

<sup>867</sup>*Ibid.*, para. 7.797.

<sup>868</sup>*Ibid.*, para. 7.803.

<sup>869</sup>Panel Report, para. 7.867.

were not only eligible under the programs, but that export credit guarantees were in fact received in connection with exports of those products.<sup>870</sup> "Scheduled products" are those for which a WTO Member has assumed a commitment to limit the amount of export subsidies in terms of budgetary outlays and quantities exported pursuant to Articles 3, 8, and 9 of the *Agreement on Agriculture*.<sup>871</sup>

595. The Panel found that, "in respect of upland cotton and other such [supported] *unscheduled* agricultural products on record, the United States applies export credit guarantees constituting export subsidies in a manner which results in circumvention of its export subsidy commitments inconsistently with Article 10.1 of the *Agreement on Agriculture*".<sup>872</sup> In addition, the Panel found that "the United States has applied export credit guarantees constituting export subsidies within the meaning of Article 10.1 – and therefore, necessarily, not listed in Article 9.1 – in a manner which results in circumvention of export subsidy commitments in respect of" rice (a scheduled commodity).<sup>873</sup> The Panel, nonetheless, found that "[i]t has not been established, however, that such actual circumvention has resulted in respect of the twelve other United States scheduled commodities".<sup>874</sup> Finally, the Panel "decline[d] to find that the export credit guarantee programmes at issue are generally applied to scheduled agricultural products other than rice and other unscheduled agricultural products (not supported under the programmes) in a manner which threatens to lead to circumvention of United States' export subsidy commitments within the meaning of Article 10.1 of the *Agreement on Agriculture*".<sup>875</sup>

596. After making these findings, the Panel turned to the United States' argument that "the text of Article 10.2 of the *Agreement on Agriculture* reflects the deferral of disciplines on export credit guarantee programmes contemplated by [WTO] Members".<sup>876</sup> This argument was rejected by the

<sup>870</sup>*Ibid.*, para. 6.32; see also footnote 1056 to para. 7.875. At the oral hearing, the participants confirmed that this is also their understanding of what the Panel meant by the distinction that it drew between "supported" and "unsupported" products. In respect of "supported" products, the Panel stated that "[i]n the extent that it identifies products within the product coverage of the *Agreement on Agriculture* that are within our terms of reference, we consider Exhibit BRA-73 to be the relevant record evidence of such products for the purposes of this dispute" (Panel Report, footnote 1056 to para. 7.875; see also *ibid.*, footnote 1575 to para. 8.1(d)(i)).

<sup>871</sup>The Panel noted that "[t]he United States has scheduled export subsidy reduction commitments in respect of the following thirteen commodities: wheat, coarse grains, rice, vegetable oils, butter and butter oil, skim milk powder, cheese, other milk products, bovine meat, pigmeat, poultry meat, live dairy cattle, eggs". (Panel Report, footnote 1057 to para. 7.876 (referring to Schedule XX of the United States of America, Part IV, Section II, entitled "Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments", reproduced in Exhibit BRA-83 and Exhibit US-13)).

<sup>872</sup>Panel Report, para. 7.875. (original emphasis)

<sup>873</sup>Panel Report, para. 7.881.

<sup>874</sup>*Ibid.*

<sup>875</sup>*Ibid.*, para. 7.896.

<sup>876</sup>*Ibid.*, para. 7.900.

Panel, which was of the opposite view, namely, that the text of Article 10.1 "clearly indicat[es] that export credit guarantee programmes constituting export subsidies for the purposes of Article 10.1 must not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments".<sup>877</sup> The Panel found support for this interpretation in the provision's context and in its object and purpose, emphasizing in particular that Article 10.2 is a subparagraph of Article 10. According to the Panel, "[t]he title of Article 10, and the text of Article 10.1, indicates an intention to prevent Members from circumventing or 'evading' their 'export subsidy commitments'".<sup>878</sup> The Panel also rejected the United States' arguments based on subsequent practice and the drafting history.<sup>879</sup> In respect of the United States' argument on subsequent practice, the Panel stated that "[t]he record ... does not suggest that there is a discernible pattern of acts or pronouncements implying an agreement among WTO Members on the United States' interpretation of Article 10.2".<sup>880</sup> Although the Panel did not see a need to examine the drafting history, it found that "nothing in the drafting history of [Article 10.2] would compel [the Panel] to reach a different conclusion".<sup>881</sup>

597. Finally, the Panel turned to Brazil's claims under Articles 3.1(a) and 3.2 of the *SCM Agreement*, and found:

To the extent that the United States export credit guarantee programmes at issue – GSM 102, GSM 103 and SCGP – do not conform fully to these provisions in Part V of the *Agreement on Agriculture* and do not benefit from the exemption from actions provided by Article 13(c)(i) of the *Agreement on Agriculture*, they are also export subsidies prohibited by Article 3.1(a) ...

...

To the extent that the three United States export credit guarantee programmes at issue are inconsistent with Article 3.1(a), they are, consequently, also inconsistent with Article 3.2 of the *SCM Agreement*.<sup>882</sup>

<sup>877</sup>*Ibid.*, para. 7.901.

<sup>878</sup>*Ibid.*, para. 7.912. (footnote omitted)

<sup>879</sup>*Ibid.*, paras. 7.928-7.944.

<sup>880</sup>*Ibid.*, para. 7.929. (footnotes omitted)

<sup>881</sup>Panel Report, para. 7.933. The Panel did not see a need to examine the drafting history because it considered that its "examination of the text of Article 10.2 of the *Agreement on Agriculture*, in its context and in light of the object and purpose of that agreement leads to a clear interpretation of the text". (Panel Report, para. 7.933)

<sup>882</sup>*Ibid.*, paras. 7.947 and 7.948. (footnote omitted)

### 3. Arguments on Appeal

598. The United States contends that the Panel erred in analyzing whether export credit guarantees are export subsidies subject to the disciplines of Article 10.1 solely by reference to the *SCM Agreement*. According to the United States, the proper context in which to analyze the meaning of Article 10.1 with respect to export credit guarantees is Article 10.2 of the *Agreement on Agriculture*.<sup>883</sup> This provision reflects the fact that, during the Uruguay Round, WTO Members did not agree on disciplines to be applied to agricultural export credits, export credit guarantees, and insurance programs, opting instead to continue discussions, deferring the imposition of substantive disciplines until a consensus was achieved.

599. According to the United States, this interpretation of Article 10.2 is consistent with Article 10 as a whole.<sup>884</sup> Article 10.2 contributes to the prevention of circumvention of export subsidy commitments by imposing two obligations on Members: first, they must undertake to work toward the development of internationally agreed disciplines on export credit guarantees; and second "after agreement on such disciplines", they must provide export credit guarantees "only in conformity therewith".<sup>885</sup> Moreover, excluding export credit guarantees from the application of Article 10.1 is also consistent with the treatment of food aid transactions under Article 10. Because Article 10.4 of the *Agreement on Agriculture* does not explicitly exempt food aid transactions from the applicability of Article 10.1, the Panel's interpretative approach would mean that all food aid transactions constitute export subsidies under Article 10.1.<sup>886</sup>

600. The United States submits that the negotiating history confirms its interpretation that Article 10.2 makes the export subsidy disciplines in Article 10.1 inapplicable to export credit guarantees.<sup>887</sup> In addition, the United States argues that it defies logic, as well as the object and purpose of the *Agreement on Agriculture*, to take the view of the Panel whereby export credit guarantees, export credits and insurance programs would be treated as already disciplined export subsidies, yet would not be permitted to be included within the applicable reduction commitments expressly contemplated by the text.<sup>888</sup> The United States therefore requests that we reverse the Panel's finding that export credit guarantees are subject to the disciplines of Article 10.1. In addition, the United States requests that we reverse the Panel's findings that export credit guarantees to

<sup>883</sup>United States' appellant's submission, para. 341.

<sup>884</sup>*Ibid.*, para. 346.

<sup>885</sup>Quoting Article 10.2 of the *Agreement on Agriculture*.

<sup>886</sup>United States' appellant's submission, paras. 349 and 358.

<sup>887</sup>*Ibid.*, paras. 367-380.

<sup>888</sup>*Ibid.*, paras. 384-385.

agricultural commodities are subject to Articles 3.1 and 3.2 of the *SCM Agreement*. The United States asserts that, because export credit guarantees currently are not subject to export subsidy disciplines under the *Agreement on Agriculture*, the export subsidy disciplines of the *SCM Agreement* are also inapplicable to these measures pursuant to Article 21.1 of the *Agreement on Agriculture* and the introductory language of Article 3.1 of the *SCM Agreement*.<sup>889</sup>

601. Brazil requests that we reject the United States' appeal from the Panel's finding that export credit guarantees are subject to the export subsidy disciplines in Article 10.1 of the *Agreement on Agriculture*. Brazil asserts that subsidized export credit guarantees are covered by the general definition of "export subsidies" under Article 1(e) of the *Agreement on Agriculture* and that these measures are, therefore, subject to Article 10.1 of the *Agreement on Agriculture*, unless an exception is provided in Article 10.2.<sup>890</sup> The text of Article 10.2 establishes two obligations, but does not provide an exception.<sup>891</sup>

602. According to Brazil, the Panel's interpretation is consistent with the context and object and purpose of Article 10.2. Each of the paragraphs in Article 10 pursues the aim of "preventing circumvention" of export subsidy commitments and, thereby, contributes to the purpose of the *Agreement on Agriculture* of establishing specific binding commitments on export competition. Therefore, Article 10.2 also must be interpreted in a manner that ensures that it contributes to the purpose of preventing circumvention of commitments on export competition.<sup>892</sup> The United States' interpretation of Article 10.2 would tend in the opposite direction, leaving Members free to grant unlimited export subsidies in the form of export credit guarantees and would permit wholesale circumvention of commitments.<sup>893</sup> Brazil, furthermore, disagrees with the United States' assertion that the Panel's interpretation is an "assault" on international food security.<sup>894</sup> According to Brazil, food aid is subject to the specific disciplines in Article 10.4 of the *Agreement on Agriculture*, as well as to the general disciplines in Article 10.1.<sup>895</sup>

603. In addition, Brazil disagrees with the conclusions drawn by the United States from the negotiating history of the *Agreement on Agriculture*.<sup>896</sup> Brazil also rejects the United States'

<sup>889</sup>*Ibid.*, para. 391.

<sup>890</sup>Brazil's appellee's submission, paras. 905-906.

<sup>891</sup>*Ibid.*, para. 912.

<sup>892</sup>Brazil's appellee's submission, paras. 951-952.

<sup>893</sup>*Ibid.*, para. 953.

<sup>894</sup>United States' appellant's submission, para. 350.

<sup>895</sup>Brazil's appellee's submission, para. 940.

<sup>896</sup>*Ibid.*, para. 975.

contention that the Panel's reading of Article 10.2 is "manifestly unreasonable".<sup>897</sup> Brazil explains that, at the close of the Uruguay Round, Members agreed that they would calculate their respective export subsidy commitment levels using exclusively the export subsidies listed in Article 9.1 and thus chose to leave out of the calculation export subsidies referred to in Article 10.1. Finally, Brazil emphasizes that the Panel's interpretation does not mean that Members cannot grant export credit guarantees. Instead, it means that subsidized export credit guarantees are subject to disciplines as trade-distorting measures, and cannot be used to override export subsidy commitments.<sup>898</sup>

604. Argentina, Australia, Canada, and New Zealand are of the view that Article 10.2 of the *Agreement on Agriculture* does not provide an exception from WTO export subsidy disciplines for export credit guarantees, export credits or insurance programs, and assert that the Panel correctly interpreted this provision.<sup>899</sup> Before the Panel, the European Communities submitted that Article 10.2 of the *Agreement on Agriculture* cannot be seen as exempting export credit guarantees granted to agricultural products from WTO disciplines as this provision makes it clear that export credit guarantees are not one of the types of export subsidies listed in Article 9.1 that a Member is given a limited authorization to apply<sup>900</sup>; the European Communities did not express a view on this issue on appeal.

4. Does Article 10.2 Exempt Export Credit Guarantee Programs from Export Subsidy Disciplines?<sup>901</sup>

605. The United States argues that because export credit guarantees are specifically dealt with in Article 10.2, and this provision expressly acknowledges that Uruguay Round negotiators did not reach an agreement on the disciplines that apply to them, they cannot properly be considered to be included within the "export subsidies" covered by Article 10.1.

606. As usual, our analysis begins with the text of the provision in question. Article 10.2 reads:

Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes and, after

<sup>897</sup>*Ibid.*, paras. 926-934 (referring to the United States' appellant's submission, para. 384).

<sup>898</sup>*Ibid.*, paras. 977-978.

<sup>899</sup>Argentina's third participant's submission, para. 39; Australia's third participant's submission, para. 71; Canada's third participant's submission, para. 42; and New Zealand's third participant's submission, para. 3.65.

<sup>900</sup>Panel Report, para. 7.781.

<sup>901</sup>A separate opinion on this issue of one of the Members of the Division is set out *infra*, paras. 631-641. The relevant findings and conclusions for purposes of the recommendations and rulings to be adopted by the DSB in this dispute, pursuant to Article 17.14 of the DSU, are those set out in paragraph 763(e) and (f) of this Report.

agreement on such disciplines, to provide export credits, export credit guarantees or insurance programmes only in conformity therewith.

607. Article 10.2 refers expressly to export credit guarantee programs, along with export credits and insurance programs. Under Article 10.2, WTO Members have taken on two distinct commitments in respect of these three types of measures: (i) to work toward the development of internationally agreed disciplines to govern their provision; and (ii) after agreement on such disciplines, to provide them only in conformity therewith. The text includes no temporal indication with respect to the first commitment. There is no deadline for beginning or ending the negotiations. The second commitment does have a temporal connotation, in the sense that it is triggered only "after agreement on such disciplines". This means that "after" international disciplines have been agreed upon, Members shall provide export credit guarantees, export credits and insurance programs only in conformity with those agreed disciplines. There is no dispute between the parties that, to date, no disciplines have been agreed internationally pursuant to Article 10.2.

608. Article 10.2 does not, however, expressly define the disciplines that *currently* apply to export credits, export credit guarantees and insurance programs under the *Agreement on Agriculture*. The Panel reasoned that "in order to carve out or exempt particular categories of measures from general obligations such as the prevention of circumvention of export subsidy commitments in Article 10.1 of the *Agreement on Agriculture*, it would be reasonable to expect an explicit indication revealing such an intention in the text of the Agreement".<sup>902</sup> The Panel saw "no language in Article 10.2 which would modify the scope of application of the general export subsidy disciplines in Article 10.1 in the *Agreement on Agriculture* so as to carve out or exempt export credit guarantees from the export subsidy disciplines imposed by that Agreement".<sup>903</sup>

609. We agree with the Panel's view that Article 10.2 does not expressly exclude export credit guarantees from the export subsidy disciplines in Article 10.1 of the *Agreement on Agriculture*. As the Panel observes, were such an exemption intended, it could have been easily achieved by, for example, inserting the words "[n]otwithstanding the provisions of Article 10.1", or other similar language at the beginning of Article 10.2.<sup>904</sup> Article 10.2 does not include express language suggesting that it is intended as an exception, nor does it expressly state that the application of any export subsidy disciplines to export credits or export credit guarantees is "deferred", as the United States suggests. Given that the drafters were aware that subsidized export credit guarantees, export credits and insurance programs could fall within the export subsidy disciplines in the *Agreement on Agriculture* and the *SCM Agreement*, it would be expected that an exception would have been clearly provided had this been the drafters' intention.

610. Moreover, as the Panel explained, Article 10.2 "contrasts starkly with the text of other provisions in the covered agreements, which clearly carve out or exempt certain products or measures from certain obligations that would otherwise apply pending the development of further multilateral disciplines".<sup>905</sup> The Panel referred to Article 6.1(a) and the footnote 24 to Article 8.2(a) of the *SCM Agreement* and Article XIII of the *General Agreement on Trade in Services*, which expressly indicate that existing disciplines do not apply pending the negotiation of future disciplines.<sup>906</sup> However, Article 10.2 does not expressly exclude the application of the existing disciplines in the *Agreement on Agriculture* until such time as the specific disciplines on export credits, export credit guarantees and insurance programs are internationally agreed upon.

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<sup>902</sup> Panel Report, para. 7.903. (footnote omitted)

<sup>903</sup> *Ibid.*, para. 7.904.

<sup>904</sup> *Ibid.*, para. 7.909.

<sup>905</sup> *Ibid.*, para. 7.906.

<sup>906</sup> *Ibid.*, paras. 7.907-7.908.

611. The Panel rejected the United States' submission<sup>907</sup> that Brazil's approach would render Article 10.2 irrelevant.<sup>908</sup> In the Panel's view, "the purpose of any eventual disciplines could be further to facilitate the determination of when export credit guarantee programmes in respect of agricultural products constitute export subsidies *per se* by developing and refining existing disciplines".<sup>909</sup> Put another way, "the work envisaged in Article 10.2 would presumably elaborate further and more specific disciplines that could facilitate identification of the extent to which such export credit guarantee programmes constitute export subsidies, or to what extent export credit guarantee programmes are not permitted".<sup>910</sup> The use of the term "development" in Article 10.2 is consistent with this view. The definitions of the term "development" include: "[t]he action or process of developing; evolution, growth, maturation; ... a gradual unfolding, a fuller working-out" and "[a] developed form or product ... an addition, an elaboration".<sup>911</sup> This suggests that the disciplines to be internationally agreed will be an elaboration of the export subsidy disciplines that are currently applicable.

612. This interpretation is consistent with the reference in Article 10.2 to internationally agreed disciplines "to govern the provision of" export credits, export credit guarantees or insurance programs; alternatively, Article 10.2 could have referred to internationally agreed disciplines "to govern" export credits, export credit guarantees or insurance programs. The latter formulation ("to govern") would have been broader in scope, whereas the formulation used in Article 10.2 ("to govern the provision") is narrower. If the drafters had intended that currently no disciplines at all would apply to export credit guarantees, export credits and insurance programs, it would have made more sense for them to have chosen the broader formulation "to govern". The drafter's choice of the narrower formulation "to govern the provision of" suggests that export credit guarantees, export credits and insurance programs are not "undisciplined" in all respects, and that the disciplines to be developed have to do *only* with their *provision*. In other words, export credit guarantees, export credits and insurance programs are governed by Article 10.1 of the *Agreement on Agriculture*, but WTO Members will develop specific disciplines on the provision of these instruments.

<sup>907</sup>United States' first written submission to the Panel, paras. 163-165.

<sup>908</sup>Panel Report, para. 7.925.

<sup>909</sup>*Ibid.*

<sup>910</sup>*Ibid.*, para. 7.926. (footnote omitted)

<sup>911</sup>*Shorter Oxford English Dictionary*, 5th ed., W.R. Trumble, A. Stevenson (eds.) (Oxford University Press, 2002), Vol. 1, p. 662.

613. The Panel's interpretation of Article 10.2, which is based on a plain reading of the text, is confirmed when, in accordance with the customary rules of treaty interpretation codified in Article 31 of the *Vienna Convention*, that provision is examined in its context and in the light of the object and purpose of the *Agreement on Agriculture*, and in particular Article 10, which is entitled "Prevention of Circumvention of Export Subsidy Commitments".

614. We note that Article 10.1 of the *Agreement on Agriculture*, the provision that immediately precedes Article 10.2, reads:

Export subsidies not listed in paragraph 1 of Article 9 shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments; nor shall non-commercial transactions be used to circumvent such commitments.

615. Although Article 10.2 commits WTO Members to work toward the development of internationally agreed disciplines on export credit guarantees, export credits and insurance programs, it is in Article 10.1 that we find the disciplines that currently apply to export subsidies not listed in Article 9.1. A plain reading of Article 10.1 indicates that the only export subsidies that are excluded from its scope are those "listed in paragraph 1 of Article 9". The United States and Brazil agreed that export credit guarantees are not listed in Article 9.1.<sup>912</sup> Thus, to the extent that an export credit guarantee meets the definition of an "export subsidy" under the *Agreement on Agriculture*, it would be covered by Article 10.1. Article 1(e) of the *Agreement on Agriculture* defines "export subsidies" as "subsidies contingent upon export performance, including the export subsidies listed in Article 9 of this Agreement". (emphasis added) The use of the word "including" suggests that the term "export subsidies" should be interpreted broadly and that the list of export subsidies in Article 9 is not exhaustive. Even though an export credit guarantee may not necessarily include a subsidy component, there is nothing inherent about export credit guarantees that precludes such measures from falling within the definition of a subsidy.<sup>913</sup> An export credit guarantee that meets the definition of an export subsidy would be covered by Article 10.1 of the *Agreement on Agriculture* because it is not an export subsidy listed in Article 9.1 of that Agreement.

<sup>912</sup>Panel Report, para. 7.788.

<sup>913</sup>For discussion of the definitional elements of a subsidy in the context of the *Agreement on Agriculture*, see Appellate Body Report, *US – FSC*, para. 136, and Appellate Body Report, *Canada – Dairy*, para. 87.

616. We find it significant that paragraph 2 of Article 10 is included in an Article that is titled the "Prevention of Circumvention of Export Subsidy Commitments". As Brazil correctly points out, each paragraph in Article 10 pursues this aim.<sup>914</sup> Article 10.1 provides that WTO Members shall not apply export subsidies not listed in Article 9.1 of the *Agreement on Agriculture* "in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments; nor shall non-commercial transactions be used to circumvent such commitments". Article 10.3 pursues the aim of preventing circumvention of export subsidy commitments by providing special rules on the reversal of burden of proof where a Member exports an agricultural product in quantities that exceed its reduction commitment level; in such a situation a WTO Member is treated as if it has granted WTO-*inconsistent* export subsidies for the excess quantities, unless the Member presents adequate evidence to "establish" the contrary.<sup>915</sup> Article 10.4 provides disciplines to prevent WTO Members from circumventing their export subsidy commitments through food aid transactions. Similarly, Article 10.2 must be interpreted in a manner that is consistent with the aim of preventing circumvention of export subsidy commitments that pervades Article 10. Otherwise, it would not have been included in that provision.

617. The United States submits that Article 10.2 contributes to the prevention of circumvention because it commits WTO Members to work toward the development of internationally agreed disciplines and to provide export credit guarantees, export credits and insurance programs only in conformity with these disciplines once an agreement has been reached.<sup>916</sup> We are not persuaded by this argument. The necessary implication of the United States' interpretation of Article 10.2 is that, until WTO Members reach an agreement on international disciplines, export credit guarantees, export credits and insurance programs are subject to no disciplines *at all*. In other words, under the United States' interpretation, WTO Members are free to "circumvent" their export subsidy commitments through the use of export credit guarantees, export credits and insurance programs until internationally agreed disciplines are developed, whenever that may be. We find it difficult to believe that the negotiators would not have been aware of and did not seek to address the potential that subsidized export credit guarantees, export credits and insurance programs could be used to

<sup>914</sup>Brazil's appellee's submission, para. 951. See Appellate Body Report, *US – FSC*, para. 148 and Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, para. 74.

<sup>915</sup>Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 74. Article 10.3 of the *Agreement on Agriculture* provides:

Any Member which claims that any quantity exported in excess of a reduction commitment level is not subsidized must establish that no export subsidy, whether listed in Article 9 or not, has been granted in respect of the quantity of exports in question.

<sup>916</sup>United States' appellant's submission, para. 346.

circumvent a WTO Member's export subsidy reduction commitments. Indeed, such an interpretation would *undermine* the objective of preventing circumvention of export subsidy commitments, which is central to the *Agreement on Agriculture*.

618. The United States submits that, under the Panel's approach, international food aid transactions would be subject to the "full array of export subsidy disciplines" because they are not expressly excluded from Article 10.1.<sup>917</sup> According to the United States, this would adversely affect food security in the less developed world, which cannot be construed as the intent of the drafters.<sup>918</sup> Furthermore, the United States asserts, the Panel's approach would mean that international food aid transactions are subject to both the specific disciplines in Article 10.4 and those in Article 10.1 of the *Agreement on Agriculture*.<sup>919</sup>

619. We are unable to subscribe to the United States' arguments because we do not see Article 10.4<sup>920</sup> as excluding international food aid from the scope of Article 10.1.<sup>921</sup> International food aid is covered by the second clause of Article 10.1 to the extent that it is a "non-commercial transaction". Article 10.4 provides specific disciplines that may be relied on to determine whether international food aid is being "used to circumvent" a WTO Member's export subsidy commitments. There is no contradiction in the Panel's approach to Article 10.2 and its approach to Article 10.4. The measures in Article 10.2 and the transactions in Article 10.4 are both covered within the scope of Article 10.1. As Brazil submits, "Article 10.4 provides an example of specific disciplines that have been agreed upon for a particular type of measure and that complement the general export subsidy

<sup>917</sup>United States' appellant's submission, para. 349.

<sup>918</sup>*Ibid.*, para. 350.

<sup>919</sup>*Ibid.*, para. 358.

<sup>920</sup>Article 10.4 of the *Agreement on Agriculture* provides:

4. Members donors of international food aid shall ensure:
- (a) that the provision of international food aid is not tied directly or indirectly to commercial exports of agricultural products to recipient countries;
  - (b) that international food aid transactions, including bilateral food aid which is monetized, shall be carried out in accordance with the FAO "Principles of Surplus Disposal and Consultative Obligations", including, where appropriate, the system of Usual Marketing Requirements (UMRs); and
  - (c) that such aid shall be provided to the extent possible in fully grant form or on terms no less concessional than those provided for in Article IV of the Food Aid Convention 1986.

A new Food Aid Convention was concluded in 1999.

<sup>921</sup>Brazil's appellee's submission, para. 940.

rules" but, like Article 10.2, it does not "establish any exceptions for the measures that [it] covers".<sup>922</sup> WTO Members are free to grant as much food aid as they wish, provided that they do so consistently with Articles 10.1 and 10.4. Thus, Article 10.4 does not support the United States' reading of Article 10.2.

620. The United States also relies on the negotiating history of the *Agreement on Agriculture* to support its position.<sup>923</sup> The Panel identified the drafting history in the record. It referred to paragraph 22 of the Framework Agreement on Agriculture Reform Programme (known as the "DeZeeuw Text"), circulated in July 1990, which envisaged "concurrent negotiations to govern the use of export assistance, including 'disciplines on export credits'".<sup>924</sup> There was also a "Note on Options in the Agriculture Negotiations" of June 1991, in which the Chairman of the negotiations "requested decisions by the principals on 'whether subsidized export credits and related practices ... would be subject to reduction commitments unless they meet appropriate criteria to be established in terms of the rules that would govern export competition'".<sup>925</sup> An addendum circulated in August of 1991 set out an Illustrative List of Export Subsidy Practices and included, as item (i), "[s]ubsidized export credit guarantees or insurance programs".<sup>926</sup> In December 1991, a "Draft Text on Agriculture" was circulated by the Chairman, Article 9.3 of which stated that "[f]or the purposes of this Article, whether export credits, export credit guarantees or insurance programmes provided by governments or their agencies constitute export subsidies shall be determined on the basis of paragraphs (j) and (k) of Annex 1 to the [SCM Agreement]."<sup>927</sup> That paragraph was omitted from the "Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations"<sup>928</sup>, which was circulated later that month. Article 10.2 of the Draft Final Act reads as follows:

<sup>922</sup>Brazil's appellee's submission, para. 950.

<sup>923</sup>The United States refers to the negotiating history pursuant to Article 32 of the *Vienna Convention* (United States' appellant's submission, para. 367; see also Panel Report, footnote 1112 to para. 7.933) Article 32 provides that recourse may be had to supplementary means of interpretation, including negotiating history, to determine the meaning when the interpretation according to Article 31 "leads to a result which is manifestly absurd or unreasonable".

<sup>924</sup>Panel Report, para. 7.934.

<sup>925</sup>*Ibid.*, para. 7.935.

<sup>926</sup>*Ibid.*, para. 7.936. Item (h) referred to "[e]xport credits provided by governments or their agencies on less than fully commercial terms."

<sup>927</sup>Panel Report, para. 7.937. Article 8.2 of that text listed export subsidies subject to reduction commitments "somewhat resembling the current Article 9.1 of the *Agreement on Agriculture*", while Article 9.1 was similar to the current Article 10.1. (Panel Report, para. 7.937)

<sup>928</sup>MTN.TNC/W/FA (20 December 1991), reproduced in Exhibit US-29.

Participants undertake not to provide export credits, export credit guarantees or insurance programs otherwise than in conformity with internationally agreed disciplines.

This language was subsequently replaced by the current text of Article 10.2.<sup>929</sup>

621. The Panel did not consider that this negotiating history supported the United States' position that "the drafters intended to defer the application of any and all disciplines on agricultural export credit guarantees".<sup>930</sup> According to the Panel, "[t]he omission of paragraph 3 of Article 9 of the December 1991 Draft Text is consistent with a decision that the words were mere surplusage, because export credits, export credit guarantees and insurance programmes were within the disciplines on export subsidies according to the terms of the agreement captured".<sup>931</sup> "The omission", the Panel added, "is much less consistent with a decision to exclude such programmes from the disciplines altogether, considering the clear textual ability of the disciplines to extend to such programmes and the lack of any attention to an explicit carve-out of such programmes from the disciplines".<sup>932</sup>

622. On appeal, the United States again relies on the drafting history of the *Agreement on Agriculture*, which it considers "reflects that the Members very early specifically included export credits and export credit guarantees as a subject for negotiation and specifically elected *not* to include such practices among export subsidies in the WTO Agreements with respect to those goods within the scope of ... the *Agreement on Agriculture*".<sup>933</sup> The United States adds that "[b]y deleting an explicit reference to export credit guarantees from the illustrative list of export subsidies in Article 9.1, Members demonstrated that they had not agreed in the case of agricultural products that export credit guarantees constitute export subsidies that should be subject to export subsidy disciplines".<sup>934</sup> Finally, the United States takes issue with the Panel's explanation that draft Article 9.3 was omitted because it was mere surplusage.<sup>935</sup>

623. We agree with the Panel that the meaning of Article 10.2 is clear from the provision's text, in its context and in the light of the object and purpose of the *Agreement on Agriculture*, consistent with Article 31 of the *Vienna Convention*.<sup>936</sup> The Panel did not think it necessary to resort to negotiating history for purposes of its interpretation of Article 10.2. Even if the negotiating history

<sup>929</sup>Panel Report, paras. 7.938-7.939.

<sup>930</sup>*Ibid.*, para. 7.939.

<sup>931</sup>*Ibid.*, para. 7.940.

<sup>932</sup>*Ibid.*

<sup>933</sup>United States' appellant's submission, para. 377. (original emphasis)

<sup>934</sup>*Ibid.*, para. 378.

<sup>935</sup>*Ibid.*, para. 379.

were relevant for our inquiry, we do not find that it supports the United States' position. This is because it does not indicate that the negotiators did not intend to discipline export credit guarantees, export credits and insurance programs *at all*. To the contrary, it shows that negotiators were aware of the need to impose disciplines on export credit guarantees, given their potential as a mechanism for subsidization and for circumvention of the export subsidy commitments under Article 9. Although the negotiating history reveals that the negotiators struggled with this issue, it does not indicate that the disagreement among them related to whether export credit guarantees, export credits and insurance programs were to be disciplined at all. In our view, the negotiating history suggests that the disagreement between the negotiators related to which kinds of specific disciplines were to apply to such measures. The fact that negotiators felt that internationally agreed disciplines were necessary for these three measures also suggests that the disciplines that currently exist in the *Agreement on Agriculture* must apply pending new disciplines because, otherwise, it would mean that subsidized export credit guarantees, export credits, and insurance programs could currently be extended without any limit or consequence.

624. The United States contends that the Panel's interpretation leads to a result that is "manifestly absurd or unreasonable".<sup>937</sup> According to the United States, it "defies logic ... to take the view of the Panel in which such practices would be treated as already disciplined export subsidies yet not permitted to be included within the applicable reduction commitments expressly contemplated by the text".<sup>938</sup> The Panel's interpretation thus results in an enormous "windfall" for Brazil because the United States would have been permitted to grant export credit guarantees had such measures been listed in Article 9 of the *Agreement on Agriculture*.<sup>939</sup> The United States also submits that exemption of export credit guarantees from export subsidy disciplines of the *Agreement on Agriculture* is further demonstrated by the fact that "no export credit guarantees are reported in the schedules of the United States or any other Members ... nor are they currently subject to reporting as export subsidies".<sup>940</sup>

625. We do not agree with the United States' submission in this regard. There could have been several reasons why Members chose not to include export credit guarantees, export credits and insurance programs under Article 9.1 of the *Agreement on Agriculture*. One reason, for instance, may be that they considered that their export credit guarantee, export credit or insurance programs did

not include a subsidy component, so that there was no need to subject them to export subsidy reduction commitments. There could have been other reasons. Thus, the fact that export credit guarantees, export credits and insurance programs were not included in Article 9.1 does not support the United States' interpretation of Article 10.2. We also observe that whether WTO Members with export credit guarantee programs have reported them in their export subsidy notifications is not determinative for purposes of our inquiry into the meaning of Article 10.2. In any event, the United States and Brazil disagree about whether such programs are subject to notification requirements.<sup>941</sup>

626. Accordingly, we do not believe that Article 10.2 of the *Agreement on Agriculture* exempts export credit guarantees, export credits and insurance programs from the export subsidy disciplines in the *Agreement on Agriculture*. This does not mean that export credit guarantees, export credits and insurance programs will necessarily constitute export subsidies for purposes of the *Agreement on Agriculture*. Export credit guarantees are subject to the export subsidy disciplines in the *Agreement on Agriculture* only to the extent that such measures include an export subsidy component. If no such export subsidy component exists, then the export credit guarantees are not subject to the Agreement's export subsidy disciplines. Moreover, even when export credit guarantees contain an export subsidy component, such an export credit guarantee would not be inconsistent with Article 10.1 of the *Agreement on Agriculture* unless the complaining party demonstrates that it is "applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments". Thus, under the *Agreement on Agriculture*, the complaining party must first demonstrate that an export credit guarantee program constitutes an export subsidy. If it succeeds, it must then demonstrate that such export credit guarantees are applied in a manner that results in, or threatens to lead to, circumvention of the responding party's export subsidy commitments within the meaning of Article 10.1 of the *Agreement on Agriculture*.

627. For these reasons, we uphold the Panel's finding, in paragraphs 7.901, 7.911 and 7.932 of the Panel Report, that Article 10.2 of the *Agreement on Agriculture* does not exempt export credit guarantees from the export subsidy disciplines in Article 10.1.

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<sup>940</sup> *Ibid.*, para. 385. (footnote omitted) The United States makes this argument within the context of its assertion that the Panel's interpretation leads to a result that is "manifestly absurd or unreasonable".

<sup>941</sup> The notification requirements are set out in *Notification Requirements and Formats under the WTO Agreement on Agriculture* (PC/PL/12, 2 December 1994), submitted by the United States to the Panel as Exhibit US-99. The United States argues that the absence of a reporting requirement for export credit guarantees provides further proof that such measures are not subject to export subsidy disciplines under the *Agreement on Agriculture*. (United States' appellant's submission, paras. 384-385) Brazil disagrees and submits that, to the extent export credit guarantees constitute export subsidies, such measures are subject to notification requirements. (Brazil's appellee's submission, para. 934)

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<sup>936</sup> Panel Report, para. 7.933.

<sup>937</sup> United States' appellant's submission, para. 383.

<sup>938</sup> *Ibid.*, para. 384.

<sup>939</sup> *Ibid.*

628. Before proceeding further, we refer to the order followed by the Panel in its analysis of Brazil's claims against the United States' export credit guarantee programs. We do not find that the Panel's order of analysis was wrong or that it constituted legal error. Nor has the United States made such a claim on appeal. Nevertheless, we are struck by the fact that the Panel addressed Article 10.2 only at the end of its analysis, especially given that this provision constituted the core of the United States' defence that the disciplines of the *Agreement on Agriculture* currently do not apply to export credit guarantees at all.

5. Articles 3.1 and 3.2 of the *SCM Agreement*

629. We turn to the United States' appeal of the Panel's findings under Articles 3.1 and 3.2 of the *SCM Agreement*. According to the United States, "Article 3 of the *SCM Agreement* ... is subject in its application to Article 21.1 of the *Agreement on Agriculture*".<sup>942</sup> The United States then argues that, because "export credit guarantees are not subject to the disciplines of export subsidies for purposes of the *Agreement on Agriculture*, Article 21.1 of that Agreement renders Article 3.1(a) of the *SCM Agreement* inapplicable to such measures".<sup>943</sup> Furthermore, the United States asserts that "the exemption from action under Article 13(c) is inapplicable, because it only is effective with respect to export subsidies disciplined under the *Agreement on Agriculture*".<sup>944</sup>

630. The United States' argument is premised on the proposition that Article 10.2 of the *Agreement on Agriculture* exempts export credit guarantees from the export subsidy disciplines in that Agreement. The Panel rejected this proposition and we have upheld the Panel's finding in this regard. Therefore, because it is premised on an incorrect interpretation of Article 10.2 of the *Agreement on Agriculture*, we reject the United States' argument. We examine the United States' appeals from other aspects of the Panel's assessment of the export credit guarantee programs under Article 3 of the *SCM Agreement* in the following section of our Report.

6. Separate Opinion

631. One Member of the Division hearing this appeal wishes to set out a brief separate opinion. At the outset, I would like to make it absolutely clear that I agree with the findings and conclusions and reasoning set out in all preceding Sections of this Report, but one, namely, Section C above, which relates to Article 10.2 of the *Agreement on Agriculture*. It is only on the interpretation of Article 10.2 that I must respectfully disagree.

<sup>942</sup>United States' appellant's submission, para. 393.

<sup>943</sup>*Ibid.*

<sup>944</sup>*Ibid.*, para. 395.

632. First I wish to point out that although Article 10.1 of the *Agreement on Agriculture* covers a range of export subsidies that do not fall within the ambit of Article 9.1 of the Agreement, Members considered that it was necessary to carve out three types of programs, namely export credit guarantees, export credits and insurance programs, and to spell out in Article 10.2 their commitments with respect to those three areas. The fact that they chose to deal with these three types of measures in Article 10.2 shows that this special treatment of the three types of measures must be given meaning and weight. Put differently, Article 10.2 is the only provision in the *Agreement on Agriculture* that speaks directly to export credit guarantees, export credits and insurance programs provided in connection with agricultural goods. I read Article 10.2 as saying that WTO Members have committed to two specific undertakings: (1) "to work toward the *development*" of international agreed disciplines and (2) to provide export credit guarantees in conformity with these disciplines "*after agreement on such disciplines*". (emphasis added) Thus, the text of Article 10.2 obliges Members to "work toward the *development*" of internationally agreed disciplines to regulate the provision of export credit guarantees, as well as export credits and insurance programs.

633. A specific provision that calls on Members to "work toward the development" of disciplines strongly suggests to me that disciplines do not yet exist. Certainly reference is not made in Article 10.2 to any other disciplines found in the *Agreement on Agriculture* that apply to export credit guarantees, export credits and insurance programs provided in connection with agricultural goods. Furthermore, the second part of Article 10.2 clearly limits the application of disciplines to *after* such time as the international disciplines have been agreed upon. This is a further indication that there are no current disciplines under the *Agreement on Agriculture* that apply to export credit guarantees, export credit and insurance programs.

634. I recognize that the language of this provision is not free from ambiguity. As noted by my colleagues on the Division, the drafters could have—dare I say, should have—made their intentions even more plain. If there were no Article 10.2, then I might concur with my colleagues that to the extent that an export credit guarantee provided an export subsidy then the *Agreement on Agriculture* envisions that that subsidy portion should be addressed by Article 10.1. However, Article 10.2 does exist and the meaning of the words as I read them is entirely prospective, at least with respect to the existence of applicable disciplines.

635. I do not see my reading of Article 10.2 to be inconsistent with the provision's context and with the object and purpose of the *Agreement on Agriculture*. Article 10 is entitled "Prevention of Circumvention of Export Subsidy Commitments". I see the first part of Article 10.1 as setting out a catch-all provision, designed to potentially cover an export subsidy that is used to circumvent the reduction commitments under Article 9. In contrast, as discussed above, Article 10.2 is designed to

specifically deal with export credit programs, export credits and insurance programs, and its provisions are controlling with respect to any such programs. Although it speaks to prospective development and application of agreed disciplines, Article 10.2 is also consistent with the objective of prevention of circumvention. Its placement in Article 10 suggests a recognition that export credits, export credit guarantees and insurance programs can have the potential to circumvent export subsidy commitments.<sup>945</sup> Article 10.3 pursues the aim of preventing circumvention of export subsidy commitments by providing special rules on reversal of burden of proof when a Member's exports exceed the quantitative reduction commitments, and Article 10.4 itemizes a series of specific commitments or disciplines that apply in the area of international food aid. It is accurate, as my colleagues reason, that the language of Article 10.2 is quite different from that used in Article 10.4. While Article 10.4 establishes disciplines for food aid transactions, Article 10.2 merely foresees that disciplines will be established, in the future, for export credit guarantees, export credits and insurance programs. The fact that a single Article contains commitments with varying degrees of temporal effect and both specific and general provisions, does not support an interpretation that the general undertaking (Article 10.1) overrides the specific and prospective provision (that is, Article 10.2).

636. I also find support for my view in the negotiating history. Of course, care must be taken in relying on negotiating history and I do not wish to imply that resort to Article 32 of the *Vienna Convention* is strictly necessary in these circumstances.<sup>946</sup> Nevertheless, as I read it this history confirms my view that at the end of the Uruguay Round, negotiators had not agreed to subject export credit guarantees, export credits and insurance programs provided in connection with agricultural goods to the disciplines of the *Agreement on Agriculture* or to any other disciplines that existed at that time. Article 10.2, in my view, was intended to reflect this outcome. At one point in the negotiations, there was a proposal for applying to agricultural products the disciplines in the Illustrative List of Export Subsidies annexed to the *SCM Agreement*.<sup>947</sup> This proposal was dropped in the Draft Final Act in favour of an "undertak[ing] not to provide export credits, export credit

<sup>945</sup>In this sense, I find the United States' term "deferral" to be more meaningful than "exception" in thinking about the nature of Article 10.2 in that it acknowledges that Members are already under an obligation to develop such disciplines, albeit in the future.

<sup>946</sup>I also recognize that the negotiating materials referred to by the Panel may not formally constitute *travaux préparatoires* for purposes of Article 32 of the *Vienna Convention*.

<sup>947</sup>Panel Report, para. 7.937. Specifically, in December 1991, a "Draft Text on Agriculture" was circulated by the Chairman. Article 9.3 of the draft text stated that "[f]or the purposes of this Article, whether export credits, export credit guarantees or insurance programmes provided by governments or their agencies constitute export subsidies shall be determined on the basis of paragraphs (j) and (k) of Annex 1 to the [SCM Agreement]". (*Ibid.*, para. 7.937) Later, the Draft Final Act was circulated and it omitted paragraph 3 of Article 9 that had appeared in the previous draft. (*Ibid.*, para. 7.938)

guarantees or insurance programs otherwise than in conformity with internationally agreed disciplines"<sup>948</sup>, which in turn was replaced by the current version of Article 10.2. The previous version of Article 10.2 (in the Draft Final Act) reflected an immediate undertaking "not to provide export credit guarantees, export credits or insurance programs otherwise than in conformity with internationally agreed disciplines", whatever those may have been. In contrast, no immediate commitment is evident from the current version of Article 10.2, which instead calls for continued negotiations and for WTO Members to provide export credits, export credit guarantees or insurance programs only in conformity with internationally agreed disciplines *after* agreement on such disciplines. This suggests to me that the negotiators were aware of the need to impose disciplines on export credit guarantees, given their potential as a mechanism for circumvention, but they were unable to agree upon and identify the disciplines that were to apply to such measures until disciplines were developed in the future. Thus, in my view, the negotiating history supports an interpretation that Article 10.2 was inserted to commit WTO Members to continue negotiating on the disciplines that would apply, in the future, and that no disciplines would apply to such measures until such time as disciplines were internationally agreed upon.

637. As noted by my colleagues on the Division, the United States argues that "it defies logic, as well as the obvious object and purpose of the agreement, to take the view of the Panel in which such practices would be treated as already disciplined export subsidies yet not permitted to be included within the applicable reduction commitments expressly contemplated by the text".<sup>949</sup> Brazil argues that the United States was never willing to accept that its export credit guarantee programs constituted an export subsidy and took a calculated risk by not including them under its Article 9 reduction commitments.<sup>950</sup>

638. I agree with my colleagues on the Division that the decisions of WTO Members regarding how to schedule their export subsidy commitments have limited value for purposes of an interpretation of Article 10. However, it seems anomalous that WTO Members with export credit guarantee programs would not have sought to preserve some flexibility to provide subsidies through such programs, which flexibility would have been available to them had such programs been included under Article 9 of the *Agreement on Agriculture*. My colleagues' reading of Article 10 perceives that WTO Members intended to impose upon themselves the more onerous obligation of immediately subjecting export credit guarantees, export credits and insurance programs to the export subsidy disciplines of the *Agreement on Agriculture* rather than the less demanding obligation of working

<sup>948</sup>Panel Report, para. 7.938.

<sup>949</sup>United States' appellant's submission, para. 384.

<sup>950</sup>Brazil's response to questioning at the oral hearing.

toward the development of such disciplines. We are bound to rely upon what we have before us in the treaty provisions, and I find the same text and context leads me in the opposite direction. Namely, that the absence of reference in Article 9 to export credit guarantees, export credits and insurance programs suggests that it was believed that such measures would not be subject to any disciplines until such time as disciplines were internationally agreed upon pursuant to Article 10.2.

639. In conclusion, for these reasons and particularly my reading of the text, it is my view that, pursuant to Article 10.2, export credit guarantees, export credits and insurance programs are not currently subject to export subsidy disciplines under the *Agreement on Agriculture*, including the disciplines found in Article 10.1. In the light of Article 21.1 of the *Agreement on Agriculture* and the introductory language to Article 3.1 of the *SCM Agreement*, I am also of the view that export credit guarantees, export credits and insurance programs provided in connection with agricultural goods are not subject to the prohibition in Article 3.1(a) of the *SCM Agreement*.

640. I recognize that this interpretation of Article 10.2 perceives a significant gap in the *Agreement on Agriculture* with respect to export credit guarantees, export credits and insurance programs that apply to agricultural products. This underscores the importance of working "toward the development of international disciplines" as envisioned by Article 10.2.

641. I also recognize that this interpretation of Article 10.2 has consequential results for some of the other claims on appeal brought by both the United States and Brazil in connection with the United States' export credit guarantee programs. As to the other Sections of this Report dealing with export credit guarantees<sup>951</sup>, I agree that the legal interpretation and analyses contained therein follow logically from the view of my colleagues on the Division with respect to Article 10.2, as set forth in paragraphs 605 through 630 of this Report.<sup>952</sup>

#### D. *Export Credit Guarantees – Burden of Proof*

642. The United States submits that the Panel erred in three different ways in respect of the application of the burden of proof in assessing the United States' export credit guarantee programs under item (j) of the Illustrative List of Export Subsidies annexed to the *SCM Agreement*. First, the United States asserts that the Panel erred by applying the special rules on the burden of proof provided

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<sup>951</sup>I am referring to Sections D. *Export Credit Guarantees – Burden of Proof*, E. *Export Credit Guarantees – Necessary Findings of Fact*, F. *Export Credit Guarantees – Circumvention*, G. *Export Credit Guarantees – Articles 1.1 and 3.1(a) of the SCM Agreement* of this Report.

<sup>952</sup>The relevant findings and conclusions for purposes of the recommendations and rulings to be adopted by the DSB in this dispute, pursuant to Article 17.14 of the DSU, are those set out in paragraph 763(c) and (f) of this Report.

in Article 10.3 of the *Agreement on Agriculture* in its examination of Brazil's claim under the *SCM Agreement*. The United States emphasizes that "the burden of proof" articulated in ... Article 10.3 has no application to the *SCM Agreement*".<sup>953</sup> Secondly, the United States argues that the Panel erred by applying the special rules on burden of proof in Article 10.3 of the *Agreement on Agriculture* in examining whether the United States circumvented its export subsidy commitments in respect of upland cotton and certain other *unscheduled* agricultural products.<sup>954</sup> According to the United States, Article 10.3 does not apply at all in respect of export subsidies to an agricultural good for which the respondent has no reduction commitments.<sup>955</sup> Finally, the United States refers to three specific instances in which the Panel allegedly applied the wrong burden of proof.<sup>956</sup>

643. Brazil responds by highlighting the Panel's finding that, whichever party bore the burden of proof, Brazil had demonstrated that the export credit guarantee programs constitute export subsidies under the terms of item (j) of the Illustrative List of Export Subsidies.<sup>957</sup>

644. Before examining the specific points raised by the United States on appeal relating to the Panel's application of the burden of proof, we recall the general rule that "the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence".<sup>958</sup> Article 10.3 of the *Agreement on Agriculture*, however, "provides a special rule for proof of export subsidies that applies in certain disputes under Articles 3, 8, 9 and 10 of the *Agreement on Agriculture*".<sup>959</sup> The text of Article 10.3 reads:

Any Member which claims that any quantity exported in excess of a reduction commitment level is not subsidized must establish that no export subsidy, whether listed in Article 9 or not, has been granted in respect of the quantity of exports in question.

This provision "cleaves the complaining Member's claim" into two parts: a quantitative aspect, and an export subsidization aspect, "allocating to different parties the burden of proof with respect to the two parts".<sup>960</sup>

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<sup>953</sup>United States' appellant's submission, para. 400. (emphasis omitted)

<sup>954</sup>*Ibid.*, para. 403.

<sup>955</sup>*Ibid.*, para. 404.

<sup>956</sup>*Ibid.*, paras. 405-408.

<sup>957</sup>Brazil's appellee's submission, paras. 95 and 1015 (referring to Panel Report, para. 7.793 and footnote 948 thereto and para. 7.867).

<sup>958</sup>Appellate Body Report, *US – Wool Shirts and Blouses*, p. 14, DSR 1997:1, 323 at 335.

<sup>959</sup>Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, para. 69.

<sup>960</sup>*Ibid.*, para. 71.

645. As the Appellate Body has explained in a previous dispute, the burden of proof under Article 10.3 operates in the following manner:

... where a Member exports an agricultural product in quantities that exceed its quantity commitment level, that Member will be treated as if it has granted WTO-inconsistent export subsidies, for the excess quantities, unless the Member presents adequate evidence to "establish" the contrary. This reversal of the usual rules obliges the responding Member to bear the consequences of any doubts concerning the evidence of export subsidization.<sup>961</sup> (original emphasis)

Pursuant to Article 10.3 "the complaining Member ... is relieved of its burden, under the usual rules, to establish a *prima facie* case of export subsidization, provided that [it] has established the quantitative part of [its] claim".<sup>962</sup>

646. Having briefly set out the applicable rules on the burden of proof, we now turn to the specific points raised by the United States in this appeal. First, the United States alleges that the Panel erred by applying the "special rule" on the burden of proof set out in Article 10.3 of the *Agreement on Agriculture* to its examination of the export credit guarantees under the *SCM Agreement*, where such a rule "has no application at all".<sup>963</sup> To support its contention that the Panel applied Article 10.3 in the context of examining Brazil's claim under the *SCM Agreement*, the United States points to the following statement by the Panel:

Moreover, recalling the burden of proof articulated in Article 10.3 of the *Agreement on Agriculture*, the United States has not established that it does not provide these export credit guarantee programmes at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes.<sup>964</sup>

647. We agree with the United States that Article 10.3 of the *Agreement on Agriculture* does not apply to claims brought under the *SCM Agreement*. However, the Panel did not make the error attributed to it by the United States. The Panel made the statement relied on by the United States in the context of its assessment of the United States' export credit guarantee program under the *Agreement on Agriculture*. Although the Panel made use of the criteria set out in item (j) of the Illustrative List of Export Subsidies annexed to the *SCM Agreement* (providing these programs at premium rates inadequate to cover long-term operating costs and losses) it did so as contextual

<sup>961</sup> Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, para. 74.

<sup>962</sup> *Ibid.*, para. 75.

<sup>963</sup> United States' appellant's submission, para. 399. (emphasis added)

<sup>964</sup> Panel Report, para. 7.868.

guidance for its analysis under the *Agreement on Agriculture*, and both the United States and Brazil appear to have agreed with the appropriateness of this approach.<sup>965</sup> Thus, the Panel's reference to Article 10.3 did not relate to its assessment of the United States' export credit guarantee programs under the *SCM Agreement*.

648. Moreover, we note that in the immediately preceding paragraph, which the United States fails to mention, the Panel stated:

We have conducted a detailed examination of the relevant evidence and argumentation submitted by the parties. On the basis of the totality of the record evidence, including approaches regularly relied upon by the United States government itself, we find that Brazil has established that the United States CCC provides the GSM 102, GSM 103 and SCGP export credit guarantee programmes "at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes" within the meaning of item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*. Our view is based on a careful consideration of the evidence, taken as a whole, and no one element, in isolation, is determinative.<sup>966</sup> (underlining added)

It is clear from this paragraph that the Panel placed the burden of proof on Brazil and determined that Brazil met its burden of proving that the United States' export credit guarantees are provided at premium rates that are inadequate to cover long-term operating costs and losses. The Panel's statement on which the United States relies simply makes the point that the United States did not rebut the case that was made out by Brazil. The reference to Article 10.3 does not, by itself, change the fact that the Panel ultimately placed the burden of proof on Brazil.

649. After making its findings under the *Agreement on Agriculture*, the Panel examined the United States' export credit guarantees under the *SCM Agreement*. There is no reference to Article 10.3 of the *Agreement on Agriculture* in this discussion.<sup>967</sup> We are aware that the Panel applied the "contextual" analysis" that it had conducted "under item (j) of the Illustrative List of Export Subsidies ... for the purposes of determining whether or not an export subsidy exists within the meaning of Article 10.1 of the *Agreement on Agriculture*" to its examination of "Brazil's claims under item (j)/Article 3.1(a) of the *SCM Agreement*".<sup>968</sup> In doing so, it would have been useful for the Panel to have clarified that the special rules on the burden of proof in Article 10.3 of the *Agreement on Agriculture*, to which it had referred previously in its "contextual" analysis of item (j) under the

<sup>965</sup> Panel Report, para. 7.803.

<sup>966</sup> *Ibid.*, para. 7.867.

<sup>967</sup> See *ibid.*, paras. 7.946-7.948.

<sup>968</sup> *Ibid.*, para. 7.946 (footnote omitted)

*Agreement on Agriculture*, were not applicable for purposes of its analysis under the *SCM Agreement*.<sup>969</sup> Because we have found that the Panel did not ultimately relieve Brazil of its burden of proof in determining that the United States' export credit guarantee programs constituted export subsidies under the *Agreement on Agriculture*, we do not believe that the Panel's failure to clarify that Article 10.3 of the *Agreement on Agriculture* did not apply to its examination of the same measures under the *SCM Agreement* constitutes reversible legal error.

650. Secondly, the United States submits that the Panel erred by applying the special rules on the burden of proof in Article 10.3 of the *Agreement on Agriculture* in examining whether the United States circumvented its export subsidy commitments in respect of upland cotton and certain other *unscheduled* agricultural products.<sup>970</sup> According to the United States, Article 10.3 applies only to agricultural products for which a WTO Member has assumed export subsidy reduction commitments in its schedule, pursuant to Article 9.1 of the *Agreement on Agriculture*.<sup>971</sup>

651. The Panel's view was that Article 10.3 does apply to *unscheduled* products:

With respect to upland cotton and other *unscheduled* products, the Panel considers that the United States' reduction commitment level, for the purposes of Article 10.3, is zero for each *unscheduled* product. By virtue of the second clause of Article 3.3, that is the level to which a Member must reduce any Article 9.1 export subsidies that were not in fact specifically made subject to "scheduled" reduction commitments. Accordingly, in the case of upland cotton and other *unscheduled* products the same sequence is to be followed, with Brazil as the complaining party first having to prove that United States' exports of *unscheduled* products exceed that "zero" level.<sup>972</sup>

652. We disagree with the Panel's view that Article 10.3 applies to *unscheduled* products. Under the Panel's approach, the only thing a complainant would have to do to meet its burden of proof when bringing a claim against an *unscheduled* product is to demonstrate that the respondent has exported that product. Once that has been established, the respondent would have to demonstrate that it has not provided an export subsidy.<sup>973</sup> This seems to us an extreme result. In effect, it would mean that any

<sup>969</sup>Panel Report, paras. 7.946-7.948.

<sup>970</sup>United States' appellant's submission, para. 403 (referring to Panel Report, para. 7.875).

<sup>971</sup>*Ibid.*, para. 404.

<sup>972</sup>Panel Report, para. 7.793. (footnote omitted)

<sup>973</sup>As the Appellate Body explained, when the special rule on burden of proof in Article 10.3 applies, then "the complaining party is not required to lead in the presentation of evidence to panels, and it might well succeed in its claim even if it presents no evidence—should the responding Member fail to meet its legal burden to establish that no export subsidy has been granted with respect to the excess quantity". (Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and the US II)*, para. 75)

export of an *unscheduled* product is *presumed* to be subsidized. In our view, the presumption of subsidization when exported quantities exceed the reduction commitments makes sense in respect of a *scheduled* product because, by including it in its schedule, a WTO Member is reserving for itself the right to apply export subsidies to that product, within the limits in its schedule. In the case of *unscheduled* products, however, such a presumption appears inappropriate. Export subsidies for both *unscheduled* agricultural products and industrial products are completely prohibited under the *Agreement on Agriculture* and under the *SCM Agreement*, respectively. The Panel's interpretation implies that the burden of proof with regard to the same issue would apply differently, however, under each Agreement: it would be on the respondent under the *Agreement on Agriculture*, while it would be on the complainant under the *SCM Agreement*.

653. Although we disagree with the Panel's interpretation of Article 10.3 of the *Agreement on Agriculture* in respect of *unscheduled* products, we do not believe that the Panel's ultimate finding is erroneous. This is because the Panel did not rely on its interpretation of Article 10.3. In a footnote to the paragraph quoted above, the Panel stated:

In any event, even if there is *no* reduction commitment level in respect of *unscheduled* products, affecting the rules of burden of proof that apply to Brazil's claims pertaining to *unscheduled* products so as to remove the burden entirely from Brazil or to place the entire burden on Brazil to prove not only that exports have been made, but even that export subsidies have been provided in respect of such exported products, this would not materially affect our analysis, as we are of the view that Brazil has discharged this burden as well, and the United States has failed to discharge its burden in this respect.<sup>974</sup> (original emphasis)

Thus the Panel placed the burden on Brazil to establish that the United States provided export subsidies, through export credit guarantees, to upland cotton and other *unscheduled* products. This is confirmed in the following paragraph:

<sup>974</sup>Panel Report, footnote 948 to para. 7.793.

Recalling our discussion of the applicable burden of proof, we find that Brazil has shown that export credit guarantees – constituting export subsidies within the meaning of Article 10.1 (and therefore, necessarily, not listed in Article 9.1) – have been provided under the programmes in question during the period we have examined in respect of exports of upland cotton and certain other unscheduled agricultural products. The United States has not shown that no export subsidy has been granted in respect of such products. We therefore conclude that, in respect of upland cotton and other such *unscheduled* agricultural products on record, the United States applies export credit guarantees constituting export subsidies in a manner which results in circumvention of its export subsidy commitments inconsistently with Article 10.1 of the *Agreement on Agriculture*.<sup>975</sup> (footnote omitted; original emphasis)

654. It is clear from the first sentence in this paragraph that the Panel imposed on Brazil the burden of demonstrating that export subsidies have been granted to upland cotton and other unscheduled agricultural products supported under the programs. The second sentence, on which the United States relies in its submission, simply indicates that the United States did not rebut the evidence and arguments put forward by Brazil; it does not indicate that the Panel erroneously placed the burden of proof on the United States.

655. Finally, the United States refers to three specific instances in which the Panel allegedly erred by improperly placing the burden of proof on the United States. The first example cited by the United States is the Panel's statement that the premiums charged by the CCC for the export credit guarantees "are not geared toward *ensuring* adequacy to cover long-term operating costs and losses for the purposes of item (j)".<sup>976</sup> The United States asserts that this is "a much higher threshold" than that provided in text of item (j) of the Illustrative List of Export Subsidies annexed to the *SCM Agreement*.<sup>977</sup> Next, the United States takes issue with the Panel's statements that "[i]n terms of the structure, design, and operation of the export credit guarantee programmes [we] believe that the programmes are not designed to avoid a net cost to government"<sup>978</sup> and that the Panel was entitled to inquire whether revenue "would be likely to cover the total of all operating costs and losses under the programme".<sup>979</sup> According to the United States, "to 'avoid a net cost' prospectively is simply not the requirement of item (j)" and the "likelihood" standard of performance" imposed by the Panel is

<sup>975</sup>Panel Report, para. 7.875.

<sup>976</sup>United States' appellant's submission, para. 406 (referring to Panel Report, para. 7.859). (emphasis added by the United States)

<sup>977</sup>*Ibid.*, para. 406.

<sup>978</sup>*Ibid.*, para. 407 (referring to Panel Report, para. 7.857).

<sup>979</sup>*Ibid.*, para. 407 (referring to Panel Report, paras. 7.805 and 7.835).

"higher than that found in item (j)".<sup>980</sup> The third example cited by the United States is the Panel's statement that "[w]e have not been persuaded that cohort re-estimates over time, will *necessarily* not give rise to a net cost to the United States government."<sup>981</sup> The United States contends that "[u]nder the applicable burden of proof, however, it is not for the United States to make such incontrovertible demonstrations to the Panel, and the Panel erred in requiring it".<sup>982</sup>

656. In our view, none of these statements demonstrates that the Panel improperly applied the rules on burden of proof. The United States is selecting statements made by the Panel within its broader analysis of how the United States' export credit guarantee programs operate, reading them in isolation, and disregarding the context in which they were made. As indicated earlier<sup>983</sup>, it is clear that the Panel imposed on Brazil the overall burden of proving that the premiums charged under the United States' export credit guarantee programs are inadequate to cover long-term operating costs and losses. This approach is consistent with the usual rules on the allocation of the burden of proof whereby the complaining party is responsible for proving its claim.<sup>984</sup> As for the Panel's rejection of the United States' submissions relating to the cohort re-estimates<sup>985</sup>, we agree with Brazil that "[a]s the party asserting that the trends existed, the United States bore the burden of proving that they existed".<sup>986</sup> Thus, the Panel cannot be said to have improperly reversed the burden of proof. Accordingly, the isolated statements referred to by the United States do not demonstrate an error by the Panel in the application of the burden of proof.

657. We, therefore, *reject* the United States' allegations that the Panel improperly applied the burden of proof in finding that the United States' export credit guarantee programs are prohibited export subsidies under Article 3.1(a) of the *SCM Agreement* and are consequently inconsistent with Article 3.2 of that Agreement.

<sup>980</sup>United States' appellant's submission, para. 407.

<sup>981</sup>*Ibid.*, para. 408 (quoting Panel Report, para. 7.853). (emphasis added by the United States) The United States also mentions the following statement by the Panel: "[w]hile there may be a possibility (based on the experience of certain of other cohorts) that this figure may diminish over the lifetime of the cohort concerned, there is no assurance that this figure will *necessarily* evolve towards, and conclude as, zero or a negative figure." (Panel Report, footnote 1028 to para. 7.853) (emphasis added by the United States)

<sup>982</sup>United States' appellant's submission, para. 408.

<sup>983</sup>See *supra*, para. 648 (quoting Panel Report, para. 7.867).

<sup>984</sup>We emphasize that the United States' argument on this specific point is limited to the Panel's application of the burden of proof. The United States has not argued that the Panel incorrectly *interpreted* item (j) as requiring that export credit guarantee programs be "geared toward ensuring adequacy to cover long-term operating costs and losses" or that such programs "avoid a net cost" prospectively".

<sup>985</sup>Panel Report, para. 7.853; see *supra*, para. 655.

<sup>986</sup>Brazil's appellee's submission, para. 1027.

E. *Export Credit Guarantees – Necessary Findings of Fact*

658. We turn to the United States' claim that the Panel erred by failing to make factual findings that were allegedly necessary for the Panel's analysis of whether premiums are adequate to cover the long-term operating costs and losses of the United States' export credit guarantee programs under item (j) of the Illustrative List of Export Subsidies annexed to the *SCM Agreement*.

659. In the United States' view, "the absence of a specific factual finding on the basis for and monetary extent to which the United States has allegedly not covered its long-term operating costs and losses for the CCC export credit guarantee programs, compels the reversal of the Panel's finding in respect of item (j)".<sup>987</sup> The United States explained that item (j) requires a determination whether premium rates are inadequate to cover long-term costs and losses and that this requires some determination as to what the operating costs and losses are. The United States further argued that the Panel's failure consisted in not making any determination about how to treat the rescheduled debt within operating costs and losses.<sup>988</sup>

660. Brazil responds that the United States has not made a proper claim under Article 11 of the DSU and is thus precluded from challenging the Panel's appreciation of the facts.<sup>989</sup> In any event, Brazil submits that neither item (j), nor Articles 3.1(a) and 3.2 of the *SCM Agreement*, nor Articles 10.1 and 8 of the *Agreement on Agriculture*, required the Panel to make specific factual findings on the "monetary extent to which" premium rates are inadequate to cover the long-term operating costs and losses of the United States' export credit guarantee programs. It was sufficient for the Panel to have found that, under any and all methodologies that it reviewed and accepted, premium rates are *inadequate* to cover the long-term operating costs and losses of the export credit guarantee programs.<sup>990</sup>

661. In addition, Brazil asserts that the Panel made sufficient factual findings "on the basis for"<sup>991</sup> its conclusion that premium rates are inadequate to cover the long-term operating costs and losses of the export credit guarantee programs. Specifically, the Panel assessed the performance of the export credit guarantee programs under the elements of item (j) in various ways. In its assessment of the *past performance* of the ECG programs during the period 1992-2002, the Panel used two accounting

<sup>987</sup>United States' appellant's submission, para. 419.

<sup>988</sup>United States' response to questioning at the oral hearing.

<sup>989</sup>Brazil's appellee's submission, para. 1065.

<sup>990</sup>*Ibid.*, para. 99.

<sup>991</sup>*Ibid.*, para. 100.

methodologies—*net present value accounting*, and *cash basis accounting*—to determine whether premium rates are inadequate to cover the long-term operating costs and losses of the programs.<sup>992</sup>

662. Before proceeding to the merits of the United States' claim, we examine first Brazil's allegation that the United States had to bring its claim, that the Panel did not make the necessary findings of fact, under Article 11 of the DSU. Article 11 of the DSU provides that a "panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case".<sup>993</sup> The Appellate Body stated in *Canada – Wheat Exports and Grain Imports* that "an appellant is free to determine how to characterize its claims on appeal"<sup>994</sup>, but observed that "due process requires that the legal basis of the claim be sufficiently clear to allow the appellee to respond effectively."<sup>995</sup>

663. The United States has styled its claim as related to the interpretation and application of item (j) of the Illustrative List of Export Subsidies annexed to the *SCM Agreement*. According to the United States, the Panel could not have reached a legal conclusion under item (j) without having necessarily determined what were the long-term operating costs and losses of the United States' export credit guarantee programs, and more specifically, made a determination in respect of the treatment of rescheduled debt. We find no difficulty with the United States' approach. Its claim relates to the Panel's application of item (j) to the specific facts of the case. The United States is not asking us to review the Panel's factual findings, nor is it arguing that the Panel's assessment of the matter was not objective. Instead, the United States' claim relates to the application of the legal standard set out in item (j) of the Illustrative List of Export Subsidies to the specific facts of this case.<sup>996</sup> It is an issue of legal characterization.<sup>997</sup> Thus, we do not agree with Brazil's contention that the United States was under an obligation to bring its claim under Article 11 of the DSU. Consequently, our inquiry will be limited to the Panel's application of the law to the facts in this case.

<sup>992</sup>Brazil's appellee's submission, para. 101.

<sup>993</sup>The Appellate Body has emphasized that "a claim, by an appellant, that a panel erred under Article 11 of the DSU, and a request for a finding to this effect, must be included in the Notice of Appeal, and clearly articulated and substantiated in an appellant's submission with specific arguments". (Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review*, footnote 60 to para. 71; see also Appellate Body Report, *Japan – Apples*, para. 127; Appellate Body Report, *US – Steel Safeguards*, para. 498; and Appellate Body Report, *Canada – Wheat Exports and Grain Imports*, para. 177.)

<sup>994</sup>Appellate Body Report, *Canada – Wheat Exports and Grain Imports*, para. 177.

<sup>995</sup>The Appellate Body, however, did not need to decide in that appeal whether to reject the appellant's claim on the basis that it was brought under the substantive provision at issue, rather than Article 11 of the DSU. (Appellate Body Report, *Canada – Wheat Exports and Grain Imports*, para. 177.)

<sup>996</sup>Appellate Body Report, *Canada – Periodicals*, p. 22, DSR 1997:1, 449 at 468.

<sup>997</sup>Appellate Body Report, *EC – Hormones*, para. 132.

664. Turning to the merits of the United States' allegation, we note that item (j) of the Illustrative List of Export Subsidies, which is attached to the *SCM Agreement* as Annex I, reads:

The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the cost of exported products or of exchange risk programmes, at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes.

665. The Panel provided the following explanation of the examination that is required under item (j) of the Illustrative List of Export Subsidies:

... item (j) calls for an examination of whether the premium rates of the export credit guarantee programme at issue are inadequate to cover the long-term operating costs and losses of the programmes. Beyond that, item (j) does not set forth, or require us to use, any one particular methodological approach nor accounting philosophy in conducting our examination. Nor are we required to quantify precisely the amount by which costs and losses exceeded premiums paid.<sup>998</sup>

We agree with the Panel's approach. The text of item (j) does not suggest that this provision requires a Panel to choose one particular basis for the calculation and then to make a precise quantification of the difference between premiums and long-term operating costs and losses on that basis. Indeed, at the oral hearing, the United States acknowledged that the text of item (j) does not, by its own terms, require precise quantification, but asserted that the Panel should have precisely quantified the long-term operating costs and losses "in this particular case".<sup>999</sup>

666. In our view, the focus of item (j) is on the inadequacy of the premiums.<sup>1000</sup> To us, this focus suggests that what is required is a finding on whether the premiums are insufficient and thus whether the specific export credit guarantee program at issue constitutes an export subsidy, and not a finding of the precise difference between premiums and long-term operating costs and losses.<sup>1001</sup>

<sup>998</sup>Panel Report, para. 7.804.

<sup>999</sup>United States' response to questioning at the oral hearing.

<sup>1000</sup>The Panel observed that there was no disagreement between the parties in this case about the meaning of the term "premiums" for purposes of item (j). According to the Panel, "[u]nder the GSM 102, GSM 103 and SCGP export credit guarantee programmes, such 'premiums' are the fees paid by the applicant exporter constituting the consideration for the payment guarantee provided by the CCC". (Panel Report, paras. 7.817-7.818)

<sup>1001</sup>"Inadequate" is defined as "Not adequate; insufficient". (*Shorter Oxford English Dictionary*, 5th ed., W.R. Trumble, A. Stevenson (eds.) (Oxford University Press, 2002), Vol. 1, p. 1338)

667. Having said this, we recognize that item (j) sets out a test that is essentially financial, as it requires a panel to look at the financial performance of an export credit guarantee program, that is, its revenues from premiums and its long-term operating costs and losses. Our review of the Panel record confirms that, in this case, the Panel conducted a financial analysis of the United States' export credit guarantee programs using three approaches. First, the Panel looked at the method used by the United States government, which "utilizes a 'net present value' approach to budget accounting for its export credit guarantee programmes".<sup>1002</sup> The Panel explained that "a positive net present value means that the United States government is extending a 'subsidy' to borrowers; a negative present value means that the programme generates a 'profit' (excluding administrative costs) to the United States government".<sup>1003</sup> Having explained the method used by the United States government, the Panel then observed that:

The annual entries in the "guaranteed loan subsidy" line in the United States budget, 1992-2002 (plus 2003 and 2004 estimates) show us that, according to this formula, there has been a positive "guaranteed loan subsidy" every year. If administrative expenses are added thereto, the annual amount of cost to the United States government increases under this formula by approximately \$39 million.<sup>1004</sup>

This shows that the Panel viewed the accounting data provided under this method used by the United States government as evidence that the premiums charged for the export credit guarantees are inadequate to cover long-term operating costs and losses.<sup>1005</sup>

668. Next, the Panel examined data submitted by Brazil based on a constructed "cost" formula.<sup>1006</sup> This formula compares the revenues and costs of the export credit guarantee programs.<sup>1007</sup> The revenue column includes premiums collected, recovered principal and interest, and interest

<sup>1002</sup>Panel Report, para. 7.842. According to the Panel, the United States government adopted the "net present value" approach starting with fiscal year 1992, pursuant to the Federal Credit Reform Act of 1990 (the "FCR Act of 1990"). A specific formula is provided under the FCR Act of 1990 for the "net present value" calculation. (*Ibid.*, footnotes 996 and 997 to para. 7.842)

<sup>1003</sup>*Ibid.*, para. 7.842.

<sup>1004</sup>*Ibid.*, para. 7.842. (footnotes omitted)

<sup>1005</sup>The Panel recognized that the "net present value" approach relies on "initial estimates of the long-term costs to the United States government". The Panel, however, stated that these were not "random guesses" but rather were based on "[a]ctual historical experience". Furthermore, the Panel reasoned that "[t]he consistently positive numbers in the United States budget guaranteed loan subsidy line indicate to us that the United States government believes, based upon its own assessment, that it may not, even over the long term, be able to operate the export credit guarantee programmes without some net cost to government". (Panel Report, para. 7.843) (original emphasis)

<sup>1006</sup>*Ibid.*, para. 7.844.

<sup>1007</sup>In its appellee's submission, Brazil describes this method as following a "cash basis accounting" approach, in which the programs' receipts are netted against disbursements on a fiscal year basis. The data on receipts and disbursements "reflect actual cash flows". (Brazil's appellee's submission, para. 985)

revenue.<sup>1008</sup> The costs column includes administrative expenses, default claims, and interest expense.<sup>1009</sup> The data used in this formula are "taken from the 'prior year' column of the United States government budget".<sup>1010</sup> The formula shows that there was a difference of a little more than US\$ 1 billion between premiums and long-term costs and losses for the period 1993-2002.<sup>1011</sup> Accordingly, the data submitted by Brazil showed that the export credit guarantee programs of the United States did not charge premiums that were adequate to cover long-term operating costs and losses.

669. After examining the data submitted by Brazil, the Panel then referred to "fiscal year/cash basis" evidence submitted by the United States. According to the United States, these data reflect "actual performance of the programmes, unlike the data in the US budget to which Brazil alludes ... which ... are based on estimates and re-estimates required under the Federal Credit Reform Act of 1990".<sup>1012</sup> The data submitted by the United States showed that, during the same period, total revenues exceeded total expenses by approximately US\$ 630 million.<sup>1013</sup>

670. The Panel proceeded to compare the two sets of data.<sup>1014</sup> In contrasting the results under the two methods, the Panel came to the conclusion that the difference between the two was mainly due to treatment of rescheduled debt. This rescheduled debt amounted to approximately US\$ 1.6 billion.<sup>1015</sup> The United States asserts that "the Panel did not make any determination about how to treat rescheduled debt".<sup>1016</sup> We disagree. In fact, the Panel rejected the approach suggested by the United States for the treatment of rescheduled debt. Under the United States' approach, rescheduled debt is

<sup>1008</sup>Brazil states that this is a "conservative" formula that credits the programs with interest revenue, even though item (j) calls for only an assessment of revenue from premiums. (Brazil's appellee's submission, para. 985)

<sup>1009</sup>See Table 3 in Panel Report, para. 7.845.

<sup>1010</sup>Panel Report, para. 7.846.

<sup>1011</sup>*Ibid.*, paras. 7.845-7.846.

<sup>1012</sup>United States' response to Question 264 Posed by the Panel (Panel Report, p. I-673, para. 21). The data were presented in a spreadsheet and submitted to the Panel as Exhibit US-128. See also Panel Report, para. 7.846.

<sup>1013</sup>Panel Report, para. 7.846.

<sup>1014</sup>The Panel acknowledged certain limitations inherent in the comparison, including the fact that some of the data "may not directly correlate", that "United States budget data may not always reflect actual performance", and the need to be especially "sensitive" to "the particular time periods covered by the data". Nevertheless, the Panel concluded that "none of these considerations undermine[s] the comparison made". (Panel Report, footnote 1006 to para. 7.846)

<sup>1015</sup>*Ibid.*, para. 7.846.

<sup>1016</sup>United States' response to questioning at the oral hearing.

not treated as an outstanding claim, but rather as a new direct loan.<sup>1017</sup> In the Panel's view, however, this approach "understates the net cost to the United States government associated with the export credit guarantee programmes at issue".<sup>1018</sup> Thus, contrary to the United States' submission, the Panel did make a determination in respect of the treatment of rescheduled debt.<sup>1019</sup> Furthermore, we read this as indicating that the Panel considered that the data submitted by the United States, once rescheduled debt was properly taken into account, also showed that premiums did not offset long-term operating costs and losses.

671. The Panel went further in its analysis and considered the evidence submitted by the United States concerning re-estimates. According to the Panel, this evidence showed a subsidy of approximately US\$ 230 million, without including administrative expenses of approximately US\$ 39 million.<sup>1020</sup> The Panel was not persuaded by the United States' submission that "over time" the re-estimates would necessarily do away with the subsidy shown by the current figures.<sup>1021</sup> In addition, we note that the Panel looked not only at the past financial performance of the United States' export credit guarantee programs, but also at the structure, design, and operation of the programs. The Panel concluded that the programs "are not designed to avoid a net cost to government"<sup>1022</sup> and "the premiums are not geared toward ensuring adequacy to cover long-term operating costs and losses for the purposes of item (j)".<sup>1023</sup>

672. In the light of the above, it is clear that the Panel undertook a sufficiently detailed examination of the financial performance of the United States' export credit guarantee programs. Its analysis showed that none of the methods proposed by the parties indicated that the premiums charged under the United States' export credit guarantee programs are adequate to cover long-term costs and

<sup>1017</sup>Panel Report, para. 7.851. In its appellee's submission, Brazil states that it "accepted that repayments made pursuant to re-scheduled debt agreements should be included as receipts under the [export credit guarantee] programs ... [but] disagreed that the full amount of re-scheduled debt should be treated as received the moment the re-scheduling agreement is completed". Instead, according to Brazil, "the default claim should continue to be treated as a loss unless the United States receives payment from the debtor, and only then should be credited as a receipt in the amount actually received from the debtor". (Brazil's appellee's submission, para. 988)

<sup>1018</sup>Panel Report, para. 7.851. The Panel was struck by the fact that "no amounts have actually been determined uncollectible, written off or forgiven" after 1992. (*Ibid.*, para. 7.848)

<sup>1019</sup>We recall that the United States has not challenged the Panel's assessment of the matter, including the assessment of the facts of the case, pursuant to Article 11 of the DSU. Thus, the United States has not asked us to review the evidentiary basis on which the Panel relied to reject the treatment of rescheduled debt by the United States.

<sup>1020</sup>Panel Report, para. 7.852. The Panel noted that figures submitted by Brazil showed a subsidy of US\$ 211 million, without administrative expenses.

<sup>1021</sup>*Ibid.*, para. 7.853.

<sup>1022</sup>*Ibid.*, para. 7.857.

<sup>1023</sup>*Ibid.*, para. 7.859.

losses. In these circumstances, we agree with the Panel that, in this particular case, it was not necessary to choose a particular method nor determine the precise amount by which long-term operating costs and losses exceeded premiums. Although it did not provide a final figure for the long-term operating costs and losses of the United States' export credit guarantee programs, as the United States suggests it should have, the Panel found that the various methods put forward by the parties led to the same conclusion, namely, that the premiums for the United States' export credit guarantee programs are inadequate to cover the programs' long-term operating costs and losses. The Panel's decision not to choose between methods or make a finding on the precise difference between premiums and long-term costs and losses does not, in our view, invalidate the Panel's ultimate findings under Articles 3.1(a) and 3.2 of the *SCM Agreement*.

673. For these reasons, we reject the United States' claim that the Panel failed to make the "necessary" findings of fact.

674. Consequently, we uphold the Panel's finding in paragraph 7.869 of the Panel Report that "the United States export credit guarantee programmes at issue – GSM 102, GSM 103 and SCGP – constitute a *per se* export subsidy within the meaning of item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*". In addition, we uphold the Panel's findings, in paragraphs 7.947 and 7.948 of the Panel Report, that these export credit guarantee programs are export subsidies for purposes of Article 3.1(a) of the *SCM Agreement* and are inconsistent with Articles 3.1(a) and 3.2 of that Agreement.

F. *Export Credit Guarantees – Circumvention*

1. Introduction

675. We turn to the issues raised by Brazil in relation to the Panel's findings under Article 10.1 of the *Agreement on Agriculture*.

676. The Panel divided its analysis of Brazil's claims under Article 10.1 into different categories, distinguishing between scheduled and unscheduled products, and supported and unsupported products (and rice as a result of its finding in respect of this product). "Scheduled products" are those for which a WTO Member has assumed a commitment to limit the amount of export subsidies in terms of budgetary outlays and quantities exported pursuant to Articles 3, 8, and 9 of the *Agreement on*

*Agriculture*.<sup>1024</sup> The Panel used the term "supported products" to refer to products for which there was evidence in the record showing that they were not only eligible under the programs, but that export credit guarantees were in fact received in connection with exports of those products.<sup>1025</sup>

677. The Panel first examined whether the United States' export credit guarantees to exports of upland cotton and other unscheduled agricultural products supported under the export credit guarantee programs are applied in a manner that "results in" circumvention for purposes of Article 10.1 of the *Agreement on Agriculture*. In other words, the Panel examined whether there is actual circumvention with respect to exports of these products. The Panel found that, "in respect of upland cotton and other such *unscheduled* agricultural products on record, the United States applies export credit guarantees constituting export subsidies in a manner which results in circumvention of its export subsidy commitments inconsistently with Article 10.1 of the *Agreement on Agriculture*".<sup>1026</sup> This finding has not been appealed.

678. The Panel next examined whether the United States' export credit guarantees to scheduled products supported under the export credit guarantee programs are applied in a manner that "results in" circumvention for purposes of Article 10.1 of the *Agreement on Agriculture*. The Panel found that "the United States has applied export credit guarantees constituting export subsidies within the meaning of Article 10.1 – and therefore, necessarily, not listed in Article 9.1 – in a manner which results in circumvention of export subsidy commitments in respect of" rice.<sup>1027</sup> In addition, the Panel found, that "[i]t has not been established, however, that such actual circumvention has resulted in respect of the twelve other United States scheduled commodities".<sup>1028</sup> Brazil appeals the latter finding by the Panel. According to Brazil, the Panel erred in finding that the United States' export credit guarantee programs are not applied in a manner that "results in" circumvention of the United States'

<sup>1024</sup>The Panel noted that "[t]he United States has scheduled export subsidy reduction commitments in respect of the following thirteen commodities: wheat, coarse grains, rice, vegetable oils, butter and butter oil, skim milk powder, cheese, other milk products, bovine meat, pigmeat, poultry meat, live dairy cattle, eggs". (Panel Report, footnote 1057 to para. 7.876 (referring to Schedule XX of the United States of America, Part IV, Section II, entitled "Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments", reproduced in Exhibit BRA-83 and Exhibit US-13))

<sup>1025</sup>Panel Report, para. 6.32; see also footnote 1056 to para. 7.875. At the oral hearing, the participants confirmed that this is also their understanding of what the Panel meant by the distinction that it drew between "supported" and "unsupported" products. In respect of "supported" products, the Panel stated that "[t]o the extent that it identifies products within the product coverage of the *Agreement on Agriculture* that are within our terms of reference, we consider Exhibit BRA-73 to be the relevant record evidence of such products for the purposes of this dispute". (Panel Report, footnote 1056 to para. 7.875; see also *ibid.*, footnote 1575 to para. 8.1(d)(i))

<sup>1026</sup>*Ibid.*, para. 7.875.

<sup>1027</sup>*Ibid.*, para. 7.881.

<sup>1028</sup>*Ibid.*

export subsidy commitments with respect to pig meat and poultry meat in 2001.<sup>1029</sup> Brazil further submits that "[i]n making this finding, the Panel erred in the interpretation and application of Article 10.1 of the *Agreement on Agriculture*, and also of Article 11 of the DSU".<sup>1030</sup>

679. The Panel also examined whether the United States' export credit guarantees to scheduled products other than rice and unscheduled products not supported under the United States' export credit guarantee programs are applied in a manner that "threatens to lead to" circumvention of the United States' export subsidy commitments for purposes of Article 10.1 of the *Agreement on Agriculture*. The Panel "decline[d] to find that the export credit guarantee programmes at issue are generally applied to scheduled agricultural products other than rice and other unscheduled agricultural products (not supported under the programmes) in a manner which threatens to lead to circumvention of United States' export subsidy commitments within the meaning of Article 10.1 of the *Agreement on Agriculture*."<sup>1031</sup>

680. Brazil makes two claims on appeal in relation to the Panel's examination of threat of circumvention. First, Brazil submits that the Panel erred in the interpretation and application of Article 10.1 in examining Brazil's claims that the United States' export credit guarantee programs "threaten[] to lead to" circumvention of the United States' export subsidy commitments.<sup>1032</sup> If the Appellate Body were to agree with Brazil and modify the Panel's interpretation, Brazil requests that the Appellate Body complete the analysis and determine that, contrary to Article 10.1 of the *Agreement on Agriculture*, export credit guarantees have been applied in a manner that threatens to lead to circumvention of the United States' export subsidy commitments for all agricultural products eligible to receive these subsidies.<sup>1033</sup> Secondly, Brazil argues that the Panel erred "by confining its examination of threatened circumvention to scheduled products other than rice and unsupported unscheduled products", despite the fact that Brazil's claim "extended to all scheduled and unscheduled agricultural products eligible to receive [export credit guarantees] export subsidies".<sup>1034</sup> We examine Brazil's allegations, in turn, below.

<sup>1029</sup>Brazil's other appellant's submission, para. 65. Brazil initially included vegetable oil in this claim. At the oral hearing, however, Brazil indicated that it was no longer pursuing this claim in respect of vegetable oil. See *infra*, para. 683.

<sup>1030</sup>*Ibid.*, para. 76.

<sup>1031</sup>Panel Report, para. 7.896.

<sup>1032</sup>Brazil's other appellant's submission, para. 63.

<sup>1033</sup>*Ibid.*, para. 64.

<sup>1034</sup>*Ibid.*, para. 75.

2. Actual Circumvention

681. We begin with Brazil's claim that the Panel erred by failing to find that the United States' export credit guarantees are applied in a manner that led to *actual* circumvention of the United States' export subsidy commitments with respect to pig meat and poultry meat in 2001.<sup>1035</sup>

682. The Panel found:

We note that the United States has not specifically discharged its burden of establishing that it did not grant WTO-inconsistent export subsidies, for the excess quantities of rice exported. Therefore, we find that the United States has applied export credit guarantees constituting export subsidies within the meaning of Article 10.1 – and therefore, necessarily, not listed in Article 9.1 – in a manner which results in circumvention of export subsidy commitments in respect of this particular scheduled commodity. It has not been established, however, that such actual circumvention has resulted in respect of the twelve other United States scheduled commodities.<sup>1036</sup>

683. In its appellant's submission, Brazil states that "according to uncontested evidence of record, supplied by the United States, actual circumvention also occurred for pig meat and poultry meat in 2001, and for vegetable oils in 2002".<sup>1037</sup> Brazil adds that the Panel "failed to properly apply a proper interpretation of Article 10.1 to the admitted facts".<sup>1038</sup> "By failing to do so", Brazil submits that the Panel "erred in the application of Article 10.1 to uncontested facts", and also "failed to make an objective assessment of the matter, including of admitted and uncontested facts supplied by the United States, as required by Article 11 of the DSU".<sup>1039</sup> In its statement at the oral hearing, Brazil acknowledged that data submitted by the United States indicated that the United States did not exceed its reduction commitment levels for vegetable oil in 2001-2002. We understand from Brazil's statement that it no longer wished to pursue this claim in respect of vegetable oil.

684. The United States responds that Brazil has not made a proper claim under Article 11 of the DSU. According to the United States, Brazil "is contesting findings of the Panel on matters of

<sup>1035</sup>The United States has scheduled export subsidy reduction commitments for pig meat and poultry meat. Consequently, the special rule on the burden of proof established in Article 10.3 applies to any quantities exported that exceed the United States' reduction commitment levels. In respect of these quantities, the United States would be "treated as if it has granted WTO-inconsistent export subsidies ... unless the [United States] presents adequate evidence to 'establish' the contrary". (Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, para. 74. (original emphasis))

<sup>1036</sup>Panel Report, para. 7.881.

<sup>1037</sup>Brazil's other appellant's submission, para. 204. (footnote omitted)

<sup>1038</sup>*Ibid.*, para. 210.

<sup>1039</sup>*Ibid.*, para. 211. (footnote omitted)

disputed fact".<sup>1040</sup> Because "Brazil does *not* appeal the Panel's factual findings that the facts did not demonstrate that subsidized exports exceeded U.S. quantitative reduction commitments for poultry, pig meat, and vegetable oils", the United States submits that Brazil's appeal is improper as it does not "stand by itself" and is not "substantiated with respect to the challenged findings".<sup>1041</sup>

685. In addition, the United States points out that Brazil's allegation of actual circumvention related to the period July 2001 through June 2002.<sup>1042</sup> In contrast, quantitative data on exports under the United States' export credit guarantee program are maintained on a fiscal year basis, which extends from 1 October to 30 September of the following year.<sup>1043</sup> In any event, even if this difference between periods can be overcome, the United States argues that "the actual data also support[] the Panel's finding that Brazil had not demonstrated actual circumvention for these products".<sup>1044</sup>

686. We understand Brazil to argue that the Panel erred both in the application of Article 10.1 of the *Agreement on Agriculture* and in its assessment of the matter pursuant to Article 11 of the DSU.<sup>1045</sup> As we explained earlier, the application of a legal rule to the specific facts of a case is an issue of legal characterization.<sup>1046</sup> In this case, we understand that Brazil's claim under Article 11 of the DSU is additional to its claim of legal error in respect of Article 10.1. We thus turn first to Brazil's claim that the Panel erred in its application of Article 10.1 of the *Agreement on Agriculture* to the facts before it.

687. It will be recalled that Article 10.1 provides:

Export subsidies not listed in paragraph 1 of Article 9 shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments; nor shall non-commercial transactions be used to circumvent such commitments.

<sup>1040</sup>United States' appellee's submission, para. 50 (footnote omitted)

<sup>1041</sup>*Ibid.*, para. 50 (referring to Appellate Body Report, *US – Steel Safeguards*, para. 498). (original emphasis; footnote omitted)

<sup>1042</sup>*Ibid.*, para. 56 (referring to Panel Report, para. 7.878 and Brazil's first written submission to the Panel, para. 265 and Figure 18). We note that the period from July of one year to June of the next year is the period used in the United States' schedule of concessions for its quantitative export subsidy commitments. See Schedule XX of the United States submitted by Brazil to the Panel as Exhibit BRA-83.

<sup>1043</sup>The fiscal year of the United States federal government is designated according to the calendar year in which it ends. Therefore, fiscal year 2001 ran from 1 October 2000 to 30 September 2001.

<sup>1044</sup>United States' appellee's submission, para. 56.

<sup>1045</sup>Brazil's response to questioning at the oral hearing; Brazil's other appellant's submission, para. 211.

<sup>1046</sup>Appellate Body Report, *EC – Hormones*, para. 132.

688. Brazil asserts that "the Panel's legal analysis of the circumstances in which actual circumvention occurs for scheduled products was correct" and draws our attention to the Panel's statement that "where the United States exports an agricultural product in quantities that exceed its quantity commitment level, it will be treated for the purposes of Article 10.1 as if it has granted WTO-inconsistent export subsidies, for the excess quantities, unless it presents adequate evidence to 'establish' the contrary".<sup>1047</sup> Brazil adds that although the Panel correctly applied this interpretation to rice, it failed to do so in respect of pig meat and poultry meat.<sup>1048</sup>

689. We observe that after finding that the United States had circumvented its commitments for rice, the Panel went on to reject Brazil's claim in respect of the other scheduled products supported under the programs without providing an explanation of the basis for its conclusion. Looking at the Panel's analysis, we note that, in paragraph 7.878, the Panel recognized that Brazil's claim of actual circumvention extended to thirteen agricultural products, including pig meat and poultry meat. In the next paragraph, the Panel refers to the United States' submission that it was in compliance with respect to nine of the products mentioned by Brazil,<sup>1049</sup> and that, in fiscal year 2002 it would also be true for poultry meat".<sup>1049</sup> Pig meat is not mentioned at all. As for poultry meat, the use of the conditional "would also be true" suggests some question about compliance with respect to that product as well, as the condition is not identified. Oddly, however, these issues are not taken up by the Panel, which does not examine any further whether there was actual circumvention for these products.

690. Instead, from that point on, the Panel focused exclusively on rice, in respect of which the Panel found that the United States failed to establish "that it did not grant WTO-inconsistent export subsidies, for the excess quantities of rice exported."<sup>1050</sup> It would appear that the Panel satisfied itself with what it considered to be an admission by the United States in respect of rice, and declined to examine further Brazil's claim in respect of the other products. In concluding, the Panel merely stated that "[i]t has not been established, however, that such actual circumvention has resulted in respect of the twelve other United States scheduled commodities".<sup>1051</sup> There is no further explanation of the reasons leading to this conclusion.

691. The Panel may have decided to satisfy itself with the United States' admission regarding rice because it allowed it to avoid having to resolve the problem posed by the different time periods used, on the one hand, to track exports under the United States' export credit guarantee programs and, on

<sup>1047</sup>Brazil's other appellant's submission, para. 205 (quoting Panel Report, para. 7.877).

<sup>1048</sup>*Ibid.*, paras. 206-207.

<sup>1049</sup>Panel Report, para. 7.879.

<sup>1050</sup>*Ibid.*, para. 7.881.

<sup>1051</sup>*Ibid.*

the other, to determine the export subsidy reduction commitments under the United States' schedule. Exports under the United States' export credit guarantee programs are tracked on a fiscal year basis, extending from 1 October to 30 September of the following year. Meanwhile, the United States' export reduction commitments are based on a year that extends from 1 July to 30 June of the following year. These periods overlap, albeit only in part.

692. We find nothing wrong in the Panel having relied on an admission by the United States relating to rice to conclude that the United States had failed to rebut Brazil's initial allegation of circumvention.<sup>1052</sup> This did not excuse the Panel, however, from specifically analyzing Brazil's claim in respect of the other products. Consequently, we find no basis to support the Panel's finding that "[i]t has not been established, however, that such actual circumvention has resulted in respect of the twelve other United States scheduled commodities".<sup>1053</sup>

693. We must determine next whether there are sufficient uncontested facts in the record to permit us to complete the analysis with respect to the other commodities.<sup>1054</sup> In our view, there are not. First, the parties disagree about the time period covered by Brazil's claim. The United States asserts that Brazil's claim was limited to the period July 2001 to June 2002, while Brazil contends that its claim was not limited to that period.<sup>1055</sup> Second, as we noted previously<sup>1056</sup>, different time periods are used for the sets of data that have to be compared. The data regarding United States exports under the export credit guarantee programs are maintained on a fiscal year basis, which extends from 1 October to 30 September of the following year.<sup>1057</sup> The United States' export subsidy commitments are registered based on a year that extends from 1 July to 30 June of the following year. Both Brazil and the United States have sought to reconcile the data.<sup>1058</sup> In each case, Brazil and the United States assert that the data support their position. Given the differences between the participants in respect of the data that we would have to examine to determine whether the United States applied export credit guarantees in a manner that results in circumvention of its export subsidy commitments for pig meat

<sup>1052</sup>Panel Report, footnote 1060 to para. 7.880.

<sup>1053</sup>*Ibid.*, para. 7.881.

<sup>1054</sup>Appellate Body Report, *US – Section 211 Appropriations Act*, para. 343.

<sup>1055</sup>Brazil's and the United States' responses to questioning at the oral hearing.

<sup>1056</sup>*Supra*, para. 691.

<sup>1057</sup>The fiscal year of the United States federal government is designated according to the calendar year in which it ends. Therefore, fiscal year 2001 ran from 1 October 2000 to 30 September 2001.

<sup>1058</sup>United States' appellee's submission, paras. 58-60; Brazil's statement at the oral hearing.

and poultry meat, we do not believe there are sufficient undisputed facts in the record to enable us to complete the analysis.

694. We recall that Brazil's claim on appeal is limited to the Panel's findings relating to pig meat and poultry meat. For the reasons mentioned above, we reverse the Panel's finding, in paragraph 7.881 of the Panel Report, that Brazil did not establish actual circumvention in respect of poultry meat and pig meat. Nevertheless, because there are insufficient uncontested facts in the record to enable us to do so, we do not complete the legal analysis to determine whether the United States' export credit guarantees to poultry meat and pig meat have been applied in a manner that "results in" circumvention of the United States' export subsidy commitments.

695. Brazil has made an additional claim that the Panel failed to make an objective assessment of the matter, as required by Article 11 of the DSU. Having reversed the Panel's ultimate finding, we find that it is not necessary for us to rule on Brazil's additional claim under Article 11 of the DSU. This is because, even if we were to agree with Brazil, it would lead to the same result that we have reached after examining the Panel's application of Article 10.1 of the *Agreement on Agriculture* to the facts before it.

### 3. Threat of Circumvention

(a) Scheduled Products Other than Rice and Unscheduled Products not Supported under the Export Credit Guarantee Programs

696. We move next to Brazil's two claims on appeal relating to the Panel's examination of *threat* of circumvention. We recall that the Panel examined whether the United States' export credit guarantees are applied in a manner that "threatens to lead to" circumvention of the United States' export subsidy commitments in respect of *scheduled products other than rice* and *unscheduled products not supported* under the export credit programs.

697. For ease of reference, we note again the text of Article 10.1, which reads:

Export subsidies not listed in paragraph 1 of Article 9 shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments; nor shall non-commercial transactions be used to circumvent such commitments.

698. The Panel explained that its conclusion on whether the United States' export credit guarantees are applied in a manner that threatens to lead to circumvention would depend on whether the Panel considered that:

... the United States export credit guarantee programmes require the provision of an 'unlimited amount' of subsidies, so that scheduled commodities other than rice and unscheduled agricultural products not supported under the programmes, therefore, benefit from those subsidies when the reduction commitment levels specified in the United States' Schedule for those agricultural products have been reached.<sup>1059</sup>

The Panel cautioned, however, that even if it made an affirmative finding, "if these programmes are not such as to necessarily create an *unconditional legal entitlement* to receive them, then there would not necessarily be such a threat".<sup>1060</sup> The Panel therefore proceeded to "examine whether an unconditional statutory legal entitlement to an export credit guarantee exists in respect of such products".<sup>1061</sup>

699. In its examination, the Panel noted that "United States export credit guarantee programmes are classified as 'mandatory' under the United States Budget Enforcement Act of 1990."<sup>1062</sup> It went on to explain, however, that it did "not believe that the 'mandatory/discretionary' distinction is the sole legally determinative one for [its] examination of whether or not 'threat' of circumvention of export subsidy commitments within the meaning of Article 10.1 of the *Agreement on Agriculture* has been proven to the required standard".<sup>1063</sup> The Panel, moreover, stated that, "[i]n order to pose a 'threat' within the meaning of Article 10.1 of the *Agreement on Agriculture*, [it did] not believe that it is sufficient that an export credit guarantee programme might possibly, or theoretically, be used in a manner which threatens to lead to circumvention of export subsidy commitments".<sup>1064</sup>

700. After examining the statutory and regulatory framework of the United States' programs under which the export credit guarantees are issued, the Panel concluded that this statutory and regulatory framework "is such that the CCC would not necessarily be required to issue guarantees in respect of any other unscheduled agricultural product (not supported under the programmes), or in respect of

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<sup>1059</sup>Panel Report, para. 7.882. (footnote omitted)

<sup>1060</sup>*Ibid.*, para. 7.883. (emphasis added)

<sup>1061</sup>*Ibid.*, para. 7.883.

<sup>1062</sup>*Ibid.*, para. 7.884. (footnote omitted)

<sup>1063</sup>*Ibid.*, para. 7.886.

<sup>1064</sup>*Ibid.*, para. 7.893.

scheduled agricultural products other than rice, in a manner which 'threatens to lead to' circumvention of export subsidy commitments".<sup>1065</sup> The Panel, therefore, found:

Keeping the applicable burden of proof in mind, we therefore decline to find that the export credit guarantee programmes at issue are generally applied to scheduled agricultural products other than rice and other unscheduled agricultural products (not supported under the programmes) in a manner which threatens to lead to circumvention of United States export subsidy commitments within the meaning of Article 10.1 of the *Agreement on Agriculture*.<sup>1066</sup>

701. Brazil asserts that the Panel erred in interpreting and applying Article 10.1 of the *Agreement on Agriculture*. According to Brazil, "[b]y] declaring that a 'possibility' of circumvention was not sufficient for a 'threat' finding under Article 10.1, the Panel mischaracterized the threat obligation, reducing it to situations of near certainty".<sup>1067</sup> Brazil explains that the ordinary meaning of the term "threat" can "encompass events that are a possibility or that appear likely; the word can also include events whose occurrence is indicated or portended by circumstances".<sup>1068</sup> Furthermore, Brazil asserts, that the meaning of the term "threatens" is clarified by its immediate context, particularly by the use of the word "prevent" in the title of Article 10.<sup>1069</sup> Brazil explains that "[f]o] give proper meaning to the aim of 'prevention,' the threat obligation should, therefore, be read in a way that it thwarts, forestalls, or stops circumvention from occurring by requiring a Member to take appropriate precautionary action".<sup>1070</sup> If, on the contrary, "the degree of likelihood necessary to trigger the threat obligation were set too high, the threat obligation would fail to 'prevent' circumvention, contrary to the express aim of the provision".<sup>1071</sup>

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<sup>1065</sup>Panel Report, para. 7.895.

<sup>1066</sup>*Ibid.*, para. 7.896.

<sup>1067</sup>Brazil's other appellant's submission, para. 95. Brazil is referring to the Panel's statement that "[i]n order to pose a 'threat' within the meaning of Article 10.1 of the *Agreement on Agriculture*, we do not believe that it is sufficient that an export credit guarantee programme might possibly, or theoretically, be used in a manner which threatens to lead to circumvention of export subsidy commitments". (Panel Report, para. 7.893)

<sup>1068</sup>Brazil's other appellant's submission, para. 97.

<sup>1069</sup>*Ibid.*, paras. 98-99. The title of Article 10 is "Prevention of Circumvention of Export Subsidy Commitments".

<sup>1070</sup>*Ibid.*, para. 100. According to Brazil, "[t]his reading of Article 10.1 of the *Agreement on Agriculture* is consistent with the Appellate Body's observation, in *US - FSC*, that the FSC measure did not provide a mechanism for "stemming or otherwise controlling" the "flow" of export subsidies. (Appellate Body Report, *US - FSC*, para. 149)

<sup>1071</sup>Brazil's other appellant's submission, para. 101.

702. Having set out its views on the meaning of the term "threatens" as used in Article 10.1 of the *Agreement on Agriculture*, Brazil then distinguishes it from the connotation that the same term is given in other covered agreements. Brazil submits that the *Agreement on Safeguards* and the *Anti-Dumping Agreement* require a higher degree of likelihood because, under both Agreements, the demonstration of "threat" triggers the *right* of a WTO Member to apply trade remedy measures involving suspension or modification of WTO commitments.<sup>1072</sup> In contrast, "Article 10.1 of the *Agreement on Agriculture* aims at the effective *enforcement* of a Member's export subsidy obligations".<sup>1073</sup> Finally, Brazil submits that the assessment of whether a threat exists under Article 10.1 must be done on a case-by-case basis and suggests a list of factors that could be considered as part of the assessment.<sup>1074</sup>

703. The United States responds by asserting that Brazil mischaracterizes the Panel's findings. Contrary to Brazil's argument, the Panel's finding that the export credit guarantee programs do not threaten circumvention of export subsidy commitments is not an articulation of a broad standard that circumvention of export subsidy commitments would only be "threatened" if beneficiaries had an "absolute" or "unconditional statutory legal entitlement" to receive the subsidies such that the United States would "necessarily" be required to grant subsidies after the commitment level had been reached.<sup>1075</sup> Rather, in concluding that the programs did not pose a threat of circumvention, the United States argues, the Panel simply was responding to and declining to adopt Brazil's erroneous factual and legal characterizations of the program.<sup>1076</sup> The United States submits, furthermore, that the Panel rightly distinguished these programs from the mandatory subsidies at issue in *US – FSC*, and the Panel's decision presents no conflict with that Appellate Body Report.<sup>1077</sup> According to the United States, Brazil effectively argued that a mere possibility of issuance of export credit guarantees presented a threat of circumvention, and the Panel simply did not adopt this theory in the context of the export credit guarantee programs.<sup>1078</sup>

<sup>1072</sup>Brazil's other appellant's submission, para. 103.

<sup>1073</sup>*Ibid.*, para. 104. (original emphasis)

<sup>1074</sup>*Ibid.*, para. 105.

<sup>1075</sup>United States' appellee's submission, paras. 6 and 27 (referring to Brazil's other appellants' submission, para. 89).

<sup>1076</sup>*Ibid.*, paras. 6 and 30.

<sup>1077</sup>*Ibid.*, para. 32.

<sup>1078</sup>*Ibid.*, paras. 6 and 35.

704. The Appellate Body has explained that "under Article 10.1, it is not necessary to demonstrate *actual* 'circumvention' of 'export subsidy commitments'".<sup>1079</sup> It suffices that "export subsidies" are "applied in a manner which ... threatens to lead to circumvention of export subsidy commitments".<sup>1080</sup> We note that the ordinary meaning of the term "threaten" includes "[c]onstitute a threat to", "be likely to injure" or "be a source of harm or danger".<sup>1081</sup> Article 10.1 is concerned not with injury, but rather with "circumvention". Accordingly, based on its ordinary meaning, the phrase "threaten[]" to lead to ... circumvention" would imply that the export subsidies are applied in a manner that is "likely to" lead to circumvention of a WTO Member's export subsidy commitments. Furthermore, we observe that the ordinary meaning of the term "threaten" refers to a *likelihood* of something happening; the ordinary meaning of "threaten" does not connote a sense of certainty.<sup>1082</sup>

705. The concept of "threat" has been discussed by the Appellate Body within the context of the *Agreement on Safeguards* and the *Anti-Dumping Agreement*. It has explained that "threat" refers to something that "has *not* yet occurred, but remains a future event whose actual materialization cannot, in fact, be assured with certainty".<sup>1083</sup> In *US – Line Pipe*, the Appellate Body stated that there is a continuum that ascends from a "threat of serious injury" up to the "serious injury" itself.<sup>1084</sup> We emphasize that the Appellate Body's discussion of the concept of "threat" in previous appeals related to the interpretation of other covered agreements that contain obligations relating to injury that differ from those relating to circumvention of export subsidy reduction commitments contained in Article 10.1 of the *Agreement on Agriculture*. Our interpretation of "threat" in Article 10.1 of the *Agreement on Agriculture* is consistent with the Appellate Body's interpretation of the term "threat" in these other contexts.

<sup>1079</sup>Appellate Body Report, *US – FSC*, para. 148. (original emphasis)

<sup>1080</sup>*Ibid.*, para. 148.

<sup>1081</sup>*Shorter Oxford English Dictionary*, 5th ed., W.R. Trumble, A. Stevenson (eds.) (Oxford University Press, 2002), Vol. 2, p. 3251.

<sup>1082</sup>Both participants agree that the determination of threat of circumvention has to be done on a case-by-case basis. (Brazil's and the United States' responses to questioning at the oral hearing.)

<sup>1083</sup>Appellate Body Report, *US – Lamb*, para. 125. (original emphasis) The Appellate Body was interpreting the phrase "threat of serious injury" within the context of Article 4.1(b) of the *Agreement on Safeguards*. Article 4.1(b) defines "threat of serious injury" as "serious injury that is clearly imminent, in accordance with the provisions of paragraph 2. A determination of the existence of a threat of serious injury shall be based on facts and not merely on allegation, conjecture or remote possibility".

<sup>1084</sup>The Appellate Body explained that "[i]n terms of the rising continuum of an injurious condition of a domestic industry that ascends from a 'threat of serious injury' up to 'serious injury', we see 'serious injury'—because it is something *beyond* a 'threat'—as necessarily *including* the concept of a 'threat' and *exceeding* the presence of a 'threat'". (Appellate Body Report, *US – Line Pipe*, para. 170) (original emphasis)

706. The Panel explained that, in its view, "threat" of circumvention under Article 10.1 requires that there be a "an unconditional legal entitlement".<sup>1085</sup> We see no basis for this requirement in Article 10.1. The Panel also stated that "[i]n order to pose a 'threat' within the meaning of Article 10.1 of the *Agreement on Agriculture*, [it did] not believe that it is sufficient that an export credit guarantee programme might possibly, or theoretically, be used in a manner which threatens to lead to circumvention of export subsidy commitments".<sup>1086</sup> In both of these statements, the Panel seems to conflate the phrase "threaten to lead to .... circumvention" with certainty that the circumvention will happen. We find it difficult, moreover, to reconcile the Panel's interpretation with the ordinary meaning of the term "threaten", which, as we indicated earlier, connotes that something is "likely" to happen.<sup>1087</sup> We also find it difficult to reconcile these statements of the Panel with its own view that it did "not believe that the 'mandatory/discretionary' distinction is the sole legally determinative one for our examination of whether or not 'threat' of circumvention of export subsidy commitments within the meaning of Article 10.1 of the *Agreement on Agriculture* has been proven to the required standard".<sup>1088</sup>

707. Nor are we prepared to accept Brazil's suggestion that the concept of "threat" in Article 10.1 should be read in a manner that requires WTO Members to take "anticipatory or precautionary action".<sup>1089</sup> The obligation not to apply export subsidies in a manner that "threatens to lead to" circumvention of their export subsidy commitments does not extend that far. There is no basis in Article 10.1 for requiring WTO Members to take affirmative, precautionary steps to ensure that circumvention of their export subsidy reduction commitments does not occur.<sup>1090</sup>

708. In concluding as it did, the Panel appears to have relied on the Appellate Body Report in *US – FSC* for guidance.<sup>1091</sup> In our view, however, the Panel misapplies that analysis. We recall that, in *US – FSC*, the Appellate Body underscored the importance of considering "the structure and other characteristics of [the] measure" when examining whether the specific measure at issue is "applied in

<sup>1085</sup>Panel Report, para. 7.883.

<sup>1086</sup>*Ibid.*, para. 7.893.

<sup>1087</sup>Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 85.

<sup>1088</sup>Panel Report, para. 7.886.

<sup>1089</sup>Brazil's other appellant's submission, para. 100.

<sup>1090</sup>We note in this respect that Article 10 is titled "Prevention of Circumvention of Export Subsidy Commitments". Brazil's assertion that Article 10.1 requires WTO Members to take precautionary action would imply that the aim of the provision would also include the prevention of *threat* of circumvention.

<sup>1091</sup>In a footnote, the Panel states that the United States' export credit guarantee programs that it was "examining are of a fundamentally different nature than the mandatory and essentially unlimited subsidy (in the form of revenue forgone that is otherwise due) examined in *US – FSC*". (Panel Report, footnote 1082 to para. 7.894)

a manner which ... threatens to lead to circumvention of export subsidy commitments".<sup>1092</sup> The Appellate Body then went on to note that the specific measure at issue in that dispute created "a *legal entitlement* for recipients to receive export subsidies, not listed in Article 9.1, with respect to agricultural products, both scheduled and unscheduled".<sup>1093</sup> This meant that there was "no discretionary element in the provision by the government of the FSC export subsidies".<sup>1094</sup> Furthermore, the Appellate Body noted that the "legal entitlement that the FSC measure establishes is unqualified as to the *amount* of export subsidies that may be claimed".<sup>1095</sup> This meant that the measure was "unlimited" because there was "no mechanism in the measure for stemming, or otherwise controlling the flow of ... subsidies that may be claimed with respect to any agricultural products".<sup>1096</sup>

709. A proper reading of the Appellate Body's statement in *US – FSC*, however, reveals that it did not intend to provide an exhaustive interpretation of threat of circumvention under Article 10.1 of the *Agreement on Agriculture*. In noting that the measure at issue in that dispute created a "legal entitlement" and had no "discretionary element", the Appellate Body was merely describing characteristics of the measure at issue in that case that it found relevant for its analysis of "threat". In other words, the Appellate Body did not foreclose, in *US – FSC*, the possibility that a measure that does not create a "legal entitlement" or that has a "discretionary element" could be found to "threaten[] to lead to circumvention" under Article 10.1 of the *Agreement on Agriculture*.

710. We therefore modify the Panel's interpretation, in paragraphs 7.882-7.883 and 7.896 of the Panel Report, of the phrase "[t]hreatens to lead to .... circumvention" in Article 10.1 of the *Agreement on Agriculture* to the extent that the Panel's interpretation requires "an unconditional legal entitlement" to receive the relevant export subsidies as a condition for a finding of threat of circumvention.

711. Having interpreted the phrase "threatens to lead to ... circumvention", we turn to Brazil's request that we complete the legal analysis and find that, contrary to Article 10.1 of the *Agreement on Agriculture*, the United States' export credit guarantee programs have been applied in a manner that threatens to lead to circumvention of the United States' export subsidy reduction commitments for all

<sup>1092</sup>Appellate Body Report, *US – FSC*, para. 149.

<sup>1093</sup>*Ibid.* (original emphasis)

<sup>1094</sup>*Ibid.*, para. 149.

<sup>1095</sup>*Ibid.* (original emphasis)

<sup>1096</sup>*Ibid.*, para. 149.

agricultural products eligible to receive these subsidies.<sup>1097</sup> According to Brazil, the alleged discretion retained by the CCC, as found by the Panel, does not operate in a manner that "mitigates the threat of circumvention".<sup>1098</sup> Brazil submits that the initial allocations by country of funds available for export credit guarantees "are repeatedly increased during the year".<sup>1099</sup> "The same is also true", Brazil asserts, "of product allocations, although the CCC makes relatively limited use of these".<sup>1100</sup> In addition, Brazil points out that "the record does not contain one single example of a situation where the CCC was unable to provide [export credit guarantees] because a country or product allocation had been exhausted ... [i]nstead, the record discloses that country and product allocations are repeatedly increased, by significant amounts, during the fiscal year as demand for [export credit guarantees] exhausts existing allocations".<sup>1101</sup>

712. Brazil also questions the significance attributed by the Panel to the fact that, under United States law, export credit guarantees may not be provided in relation to exports to a country that the Secretary of Agriculture determines "cannot adequately service the debt associated with such sale".<sup>1102</sup> According to Brazil, this statutory provision does not constrain the overall amount of export credit guarantees because "the possible exclusion of a country does not prevent the CCC from using all the [export credit guarantees] that would have gone to that country to support exports to other, eligible countries".<sup>1103</sup> Moreover, Brazil submits that the record shows that the Secretary of Agriculture has used this authority "other than sparingly" and that the current list of countries that are eligible under the United States' export credit guarantee programs include "the very large majority of the world's highly indebted poor countries".<sup>1104</sup>

713. We are not persuaded that the arguments put forward by Brazil establish that the United States' export credit guarantee programs are applied in a manner that threatens to lead to circumvention of the United States' export subsidy commitments in respect of scheduled products other than rice and unscheduled products not supported under the programs. In our view, the fact

<sup>1097</sup>Brazil's other appellant's submission, paras. 63-64 and 140.

<sup>1098</sup>*Ibid.*, para. 187.

<sup>1099</sup>*Ibid.*, para. 188.

<sup>1100</sup>*Ibid.*, para. 189. According to Brazil, less than eight percent of allocations were product-specific in 2003.

<sup>1101</sup>Brazil's other appellant's submission, para. 191. (footnote omitted)

<sup>1102</sup>Panel Report, para. 7.888 (quoting 7 USC 5622(f)(1)). The Panel stated that "[w]hile this does not curtail the amount of guarantees that may ultimately be made available, it does indicate to us that there exists a discretion (on the part of the Secretary [of Agriculture]) to determine situations in which guarantees cannot be made available". (*Ibid.*, para. 7.888)

<sup>1103</sup>Brazil's other appellant's submission, para. 195.

<sup>1104</sup>*Ibid.*, para. 196.

alone that exports of certain products are eligible for export credit guarantees is not sufficient to establish a threat of circumvention. This is particularly the case where there is no evidence in the record that exports of such products have been "supported" by export credit guarantees in the past.<sup>1105</sup> As we stated earlier, Article 10.1 of the *Agreement on Agriculture* does not require WTO Members to take affirmative, precautionary steps to ensure that circumvention of their export subsidy reduction commitments never happens. Nor is it sufficient for Brazil to have alleged that the United States has provided export credit guarantees to exports of *other* unscheduled products or to exports of scheduled products in excess of its export subsidy reduction commitments. Therefore, we agree with the Panel that Brazil has not established that the United States applies its export credit guarantee programs to scheduled agricultural products other than rice and other unscheduled agricultural products (not "supported" under the programs) "in a manner ... which threatens to lead to ... circumvention" of the United States' export subsidy commitments.

714. We thus *uphold*, albeit for different reasons, the Panel's finding, in paragraph 7.896, that Brazil has not established that "the export credit guarantee programmes at issue are generally applied to scheduled agricultural products other than rice and other unscheduled agricultural products (not supported under the programmes) in a manner which threatens to lead to circumvention of United States export subsidy commitments within the meaning of Article 10.1 of the *Agreement on Agriculture*".

(b) Rice and Unscheduled Products Supported by the Export Credit Guarantee Programs

715. We turn to Brazil's claim that the Panel improperly confined its examination of Brazil's threat claim to scheduled products other than rice and unscheduled products not supported under the programs. Put another way, Brazil submits that the Panel's analysis of "threat" of circumvention should have also included rice (a scheduled product) and unscheduled products supported by the programs (including upland cotton).<sup>1106</sup>

716. As Brazil acknowledges, the products that the Panel allegedly excluded from its "threat" analysis had been the subject of the Panel's analysis of "actual" circumvention.<sup>1107</sup> In fact, for these products, the Panel had *already* found that the United States' export credit guarantees are applied in a manner that "results in" circumvention. That is, the Panel found *actual* circumvention.<sup>1108</sup> The

<sup>1105</sup>Supported" products are described, *supra*, para. 676.

<sup>1106</sup>Brazil's other appellant's submission, para. 75.

<sup>1107</sup>*Ibid.*, para. 135 (referring to Panel Report, paras. 7.875 and 7.881).

<sup>1108</sup>Panel Report, para. 7.875.

Panel, however, explained that it was unnecessary for it to examine whether export credit guarantees for the same products were also applied in a manner that "threatens to lead to" circumvention:

Article 10.1 of the *Agreement on Agriculture* provides that export subsidies not listed in Article 9.1 "shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments ..." (emphasis added). With respect to rice and to unscheduled agricultural products supported under programmes, we have found, in paragraphs 7.875 and 7.881, that the United States applies export credit guarantee programmes constituting export subsidies in a manner which results in circumvention of its export subsidy commitments inconsistently with Article 10.1. We consider that the "or" in Article 10.1 indicates that either one (resulting in circumvention) or the other (threatening to lead to circumvention) or both in combination would be adequate to trigger the remedies associated with this provision. We also see "resulting in circumvention" as including and exceeding the concept of "threatening to lead to circumvention". ... We therefore do not believe that it is necessary to conduct any additional examination here.<sup>1109</sup> (original emphasis)

717. We believe the Panel was within its discretion in declining to examine whether scheduled products other than rice and unscheduled products supported by the programs are applied in a manner that "threatens to lead to" circumvention. The Panel had already found that the United States acted inconsistently with Article 10.1 of the *Agreement on Agriculture* because it applied its export credit guarantee program in a manner that "results in" (actual) circumvention of its export subsidy commitments for these products. We do not see why the Panel had to examine also whether the United States acted inconsistently with the *same* provision in respect of the *same* products, but on the basis of there being a *threat* of circumvention, rather than *actual* circumvention.

718. The Appellate Body has stated that panels may exercise judicial economy and refrain from addressing claims beyond those necessary to resolve the dispute.<sup>1110</sup> In this case, the Panel did not expressly state it was exercising judicial economy.<sup>1111</sup> We agree with the United States, however, that the Panel's approach can be properly characterized as an exercise of judicial economy.<sup>1112</sup> Moreover, we believe that the Panel was within its discretion in refraining from making additional findings and it

<sup>1109</sup>Panel Report, footnote 1061 to para. 7.882.

<sup>1110</sup>Appellate Body Report, *Canada – Wheat Exports and Grain Imports*, para. 133.

<sup>1111</sup>The Panel stated that it did not believe it "necessary to conduct any additional examination". (Panel Report, footnote 1061 to para. 7.882)

<sup>1112</sup>The United States asserts that "the Panel properly exercised judicial economy in not examining threat of circumvention for agricultural products with respect to which it found actual circumvention". (United States' appellee's submission, para. 42)

was not improper for the Panel to have exercised judicial economy given that its finding of *actual* circumvention resolved the matter.<sup>1113</sup>

719. Therefore, we reject Brazil's appeal that the Panel erred in confirming its examination of Brazil's threat of circumvention claim to scheduled products other than rice and unscheduled products not supported under the United States' export credit guarantee programs.

G. *Export Credit Guarantees – Articles 1.1 and 3.1(a) of the SCM Agreement*

720. We turn now to Brazil's allegation that the Panel erred by exercising judicial economy in respect of Brazil's claim that the United States' export credit guarantees are export subsidies within the meaning of Articles 1.1 and 3.1(a) of the *SCM Agreement*.

721. The Panel first examined the United States' export credit guarantees under the *Agreement on Agriculture* using the benchmark provided in item (j) of the Illustrative List of Export Subsidies attached to the *SCM Agreement* as Annex 1, albeit as context.<sup>1114</sup> The Panel found:

On the basis of the totality of the record evidence, including approaches regularly relied upon by the United States government itself, we find that Brazil has established that the United States CCC provides the GSM 102, GSM 103 and SCGP export credit guarantee programmes "at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes" within the meaning of item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*.

...

We therefore find that the United States export credit guarantee programmes at issue – GSM 102, GSM 103 and SCGP – constitute a *per se* export subsidy within the meaning of item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*.<sup>1115</sup>

722. After completing its examination under the *Agreement on Agriculture*, the Panel moved to Brazil's claims under the *SCM Agreement*. The Panel noted that it had "conducted a contextual analysis under item (j) ... for the purposes of determining whether or not an export subsidy exists within the meaning of Article 10.1 of the *Agreement on Agriculture*" and, therefore, saw "no reason ... why this analysis may not also be applied directly in an examination of the merits of Brazil's claims

<sup>1113</sup>Appellate Body Report, *Australia – Salmon*, para. 223. See also Appellate Body Report, *Canada – Wheat Exports and Grain Imports*, para. 133.

<sup>1114</sup>Panel Report, para. 7.803.

<sup>1115</sup>*Ibid.*, paras. 7.867 and 7.869.

under item (j)/Article 3.1(a) of the *SCM Agreement* in respect of the export credit guarantee programmes in this factual situation".<sup>1116</sup> The Panel found:

To the extent that the United States export credit guarantee programmes at issue – GSM 102, GSM 103 and SCGP – do not conform fully to these provisions in Part V of the *Agreement on Agriculture* and do not benefit from the exemption from actions provided by Article 13(c)(ii) of the *Agreement on Agriculture*, they are also export subsidies prohibited by Article 3.1(a) for the reasons we have already given.<sup>1125</sup>

Article 3.2 of the *SCM Agreement* provides: "A Member shall neither grant nor maintain subsidies referred to in paragraph 1" of Article 3. To the extent that the three United States export credit guarantee programmes at issue are inconsistent with Article 3.1(a), they are, consequently, also inconsistent with Article 3.2 of the *SCM Agreement*."<sup>1117</sup>

<sup>1125</sup> We recall that Article 3.1(a) of the *SCM Agreement* sets out a prohibition on subsidies contingent upon export performance, "including those illustrated in Annex I". Annex I - the Illustrative List of Export Subsidies - contains item (j). We have found that the challenged United States export credit guarantee programmes meet the definitional elements of a *per se* export subsidy in item (j). As they are among those "illustrated in Annex I" for the purposes of Article 3.1(a), they are included in the subsidies contingent upon export performance prohibited by Article 3.1(a) of the *SCM Agreement*.

723. During the interim review, Brazil requested the Panel "to make certain additional 'factual' findings regarding the parties' evidence and argumentation relating to Brazil's allegation that the CCC export credit guarantee programmes at issue constitute prohibited export subsidies under the elements of Articles 1 and 3.1(a) of the *SCM Agreement*".<sup>1118</sup> Brazil asserted that "in the event one of the parties appeals and the Appellate Body reverses the Panel's conclusion on item (j), it might not have the necessary facts at its disposal to 'complete the analysis' with respect to Brazil's claims under Articles 1 and 3.1(a) of the *SCM Agreement*".<sup>1119</sup>

724. The United States asked the Panel to reject Brazil's request, asserting that "the Panel ha[d] already made findings on the claims cited by Brazil" and, therefore, Brazil was improperly requesting

<sup>1116</sup>Panel Report, para. 7.946. (footnote omitted)

<sup>1117</sup>*Ibid.*, paras. 7.947-7.948. (footnote 1124 omitted)

<sup>1118</sup>*Ibid.*, para. 6.31.

<sup>1119</sup>*Ibid.*

the Panel "to make unnecessary and unsupported additional factual findings with respect to its *SCM Agreement* claims, and to reverse the applicable burden of proof".<sup>1120</sup>

725. The Panel declined Brazil's request because, in its view:

Brazil's allegation invoking the elements of Articles 1 and 3.1(a) of the *SCM Agreement* is not a separate claim, but merely another argument, on a different factual basis, as to how the United States export credit guarantee programmes would meet the definition of an export subsidy in Article 3.1(a) of the *SCM Agreement*. Given our finding in paragraphs 7.946-7.948, we do not believe that it is necessary to address Brazil's additional arguments about how the Article 3.1(a) definitional elements would be fulfilled on another factual basis in order to resolve this dispute. For greater clarity, we have inserted footnote 1125.<sup>1121</sup>

726. On appeal, Brazil asserts that the Panel's rejection of Brazil's request constitutes a false exercise of judicial economy. According to Brazil, "[i]n concluding that Brazil's allegations under item (j) and under Articles 1.1 and 3.1(a) of the *SCM Agreement* constitute alternative arguments, on a different factual basis, the Panel failed to recognize the distinct obligations that flow from Article 3.1(a), and the potentially distinct course of implementation triggered by a Member's maintenance of export subsidies within the meaning of Articles 1.1 and 3.1(a)".<sup>1122</sup> Brazil explains that "because of the different benchmarks that apply under item (j), on the one hand, and Articles 1.1 and 3.1(a), on the other, a measure that no longer constitutes an export subsidy under item (j) may still constitute an export subsidy under Articles 1.1 and 3.1(a)".<sup>1123</sup>

727. Brazil asserts that a "panel is obligated to address all claims on which a finding is necessary to enable the Dispute Settlement Body to make sufficiently precise recommendations and rulings to allow for 'prompt settlement' of the dispute, and for prompt compliance by a Member with those recommendations and rulings in order to ensure effective resolution of disputes to the benefit of all Members."<sup>1124</sup> It then adds that "[b]ecause a measure that no longer constitutes an export subsidy under item (j) may still constitute an export subsidy under Articles 1.1 and 3.1(a), the Panel's exercise of judicial economy in this case was in error".<sup>1125</sup> Brazil further explains that the United States "could comply with its obligations under item (j) but still fail to comply with its obligations under

<sup>1120</sup>Panel Report, para. 6.31.

<sup>1121</sup>*Ibid.* See *supra*, para. 722.

<sup>1122</sup>Brazil's other appellant's submission, para. 22 (quoting Panel Report, para. 6.31).

<sup>1123</sup>*Ibid.*, para. 22.

<sup>1124</sup>*Ibid.*, para. 23 (quoting Articles 3.2 and 21.1 of the DSU). (footnotes omitted)

<sup>1125</sup>*Ibid.*, para. 23.

Articles 1.1 and 3.1(a)".<sup>1126</sup> Therefore, in Brazil's view, the Panel's failure "to examine Brazil's claim ... leaves open a dispute and creates uncertainty concerning the scope of the United States' obligations, and the consistency of its existing measures with those obligations".<sup>1127</sup> If the Appellate Body were to agree with Brazil's assertion that the Panel's exercise of judicial economy was improper, then Brazil requests that the Appellate Body complete the analysis, and find that the United States' export credit guarantee programs constitute export subsidies under Articles 1.1 and 3.1(a) of the *SCM Agreement*.<sup>1128</sup>

728. The United States requests us to reject Brazil's claim. According to the United States, any further findings by the Panel would have been redundant as the Panel had already determined that the export credit guarantees "constitute *per se* export subsidies prohibited by Articles 3.1(a) and 3.2 of the *SCM Agreement*."<sup>1129</sup> The United States explains that "[n]either item (j) nor the Illustrative List imposes obligations *per se*".<sup>1130</sup> Rather, the obligations regarding export subsidies are found in Articles 3.1(a) and 3.2.<sup>1131</sup> The United States asserts, furthermore, that an additional finding by the Panel on the issue of whether the export credit guarantees programs confer a "benefit" would not change the United States' compliance obligations.<sup>1132</sup>

729. In addition, the United States submits that Brazil mischaracterizes what the Panel did as a failure to address a claim by Brazil when, in fact, Brazil's request at the interim review stage was for the Panel to make additional factual findings.<sup>1133</sup> Even if Brazil had made a separate claim before the Panel under Articles 1.1 and 3.1 of the *SCM Agreement*, the United States submits that the Panel could have properly exercised judicial economy, as the Appellate Body recognized, in *US – Wool Shirts and Blouses*, that panels "need only address those *claims* which must be addressed to resolve the matter in issue in the dispute".<sup>1134</sup> Finally, the United States rejects the contention that Brazil has demonstrated that the United States' export credit guarantees confer a "benefit".<sup>1135</sup>

<sup>1126</sup>Brazil's other appellant's submission, para. 23.

<sup>1127</sup>*Ibid.*

<sup>1128</sup>*Ibid.*, para. 42.

<sup>1129</sup>United States' appellee's submission, para. 62 (referring to Panel Report, para. 8.1(d)(i)).

<sup>1130</sup>*Ibid.*, para. 66

<sup>1131</sup>*Ibid.*, para. 66. The United States submits that, under Brazil's reading, the Illustrative List would be deprived of meaning. (*Ibid.*, para. 67)

<sup>1132</sup>*Ibid.*, para. 80.

<sup>1133</sup>*Ibid.*, paras. 81-82 (referring to Panel Report, para. 6.31).

<sup>1134</sup>*Ibid.*, para. 85 (referring to Appellate Body Report, *US – Wool Shirts and Blouses*, p. 19, DSR 1997:1, 323 at 339). (emphasis added)

<sup>1135</sup>*Ibid.*, paras. 92-99.

730. We observe that Brazil premises its claim on appeal on its submission that item (j) of the Illustrative List of Export Subsidies annexed to the *SCM Agreement* is a distinct obligation from that contained in Article 3.1(a), read together with Article 1.1.<sup>1136</sup> In other words, Brazil submits that the requirement in item (j) for an export credit guarantee program to charge premiums that are adequate to cover long-term operating costs and losses is distinct from the requirement, under Articles 1.1 and 3.1(a), not to confer a "benefit". The United States rejects the premise of Brazil's argument, asserting instead that the Illustrative List of Export Subsidies, and more specifically item (j), do not establish a separate obligation from that in Article 3.1(a).<sup>1137</sup> Rather, the Illustrative List provides examples (hence "illustrative") of the types of measures that constitute "export subsidies" within the meaning of Article 3.1(a) and "to the extent that it does address a practice this constitutes the standard to determine whether a particular practice constitutes a prohibited export subsidy".<sup>1138</sup>

731. We need not decide, in this case, whether an export credit guarantee program that meets the standard of item (j) of the Illustrative List of Export Subsidies—because the premiums charged are adequate to cover long-term operating costs and losses—may nevertheless be challenged as a prohibited export subsidy under Article 3.1(a) on the basis that it confers a benefit. This is because, even if we were to assume that such a claim were possible, we would conclude that the Panel was within its discretion in exercising judicial economy in respect of Brazil's claim.<sup>1139</sup>

732. As we explained earlier, panels may refrain from ruling on every claim as long as it does not lead to a "partial resolution of the matter".<sup>1140</sup> The Panel found that the United States' export credit guarantee programs constitute a prohibited export subsidy under Article 3.1(a) because they do not meet the criteria in item (j) of the Illustrative List of Export Subsidies. This finding, in our view, is sufficient to resolve the matter. Therefore, we are not persuaded that the Panel's exercise of judicial

<sup>1136</sup>Brazil's other appellant's submission, para. 22.

<sup>1137</sup>United States' appellee's submission, para. 66.

<sup>1138</sup>*Ibid.*, para. 70.

<sup>1139</sup>The Panel did not expressly state that it was exercising judicial economy. Instead, the Panel stated that it did not believe that it was "necessary to address Brazil's additional *arguments*". (Panel Report, para. 6.31) (emphasis added) Brazil initially describes the Panel's failure as an error by the Panel in the "interpretation and application of Article 3.1(a) of the *SCM Agreement*, as well as of Article 3.7 of the DSU". (Brazil's other appellant's submission, para. 22) Later in its submission, however, Brazil describes the Panel's error as a "misapplication of the principle of judicial economy". (*Ibid.*, para. 23; see also *ibid.*, paras. 33 and 39-41)

<sup>1140</sup>Appellate Body Report, *Australia – Salmon*, para. 223.

economy was improper, as Brazil has not demonstrated that it has led to "a partial resolution of the matter".<sup>1141</sup>

733. For these reasons, we reject Brazil's claim that the Panel erred by exercising judicial economy in respect of Brazil's allegation that the United States' export credit guarantees are prohibited export subsidies, under Article 3.1(a) of the *SCM Agreement*, because they confer a "benefit" within the meaning of Article 1.1.

#### H. *ETI Act of 2000*

734. We turn to Brazil's claim that the Panel erred in the "interpretation and application of the burden of proof"<sup>1142</sup>, in connection with its finding that Brazil did not establish a *prima facie* case that the ETI Act of 2000<sup>1143</sup> and the subsidies granted thereunder are inconsistent with Articles 8 and 10.1 of the *Agreement on Agriculture* and Articles 3.1 and 3.2 of the *SCM Agreement*, in respect of upland cotton.

735. Before the Panel, Brazil argued that the ETI Act of 2000 provides an export subsidy to upland cotton, within the meaning of Article 10.1 of the *Agreement on Agriculture*, because it eliminates tax liabilities for exporters who sell upland cotton in foreign markets. According to Brazil, the ETI Act of 2000 threatens to circumvent the United States' export subsidy commitments by providing an export subsidy to upland cotton, despite the fact that the United States has not scheduled any export subsidy reduction commitments for that commodity, thereby violating Articles 8 and 10.1 of the *Agreement on Agriculture*. In addition, Brazil asserted that the ETI Act of 2000 provides prohibited export

<sup>1141</sup>Appellate Body Report, *Australia – Salmon*, para. 223. As the United States argues, the circumstances of this case are different from those in *Australia – Salmon*. In that case, the panel limited its findings for other Canadian salmon to Article 5.1 of the *SPS Agreement* and "gave no convincing reason why it examined Article 5.5 and 5.6 for only one category of the products in dispute, i.e., ocean-caught Pacific salmon, and did not undertake the same analysis for other categories, i.e., other Canadian salmon". (Appellate Body Report, *Australia – Salmon*, para. 225) The present case does not involve a panel incorrectly limiting its findings under other provisions to certain products. Instead, Brazil is questioning the Panel's refusal to make an additional finding of inconsistency with the same provision for the same products.

<sup>1142</sup>Brazil's other appellant's submission, para. 7.

<sup>1143</sup>Public Law 106-519. The ETI Act of 2000 is a measure that was taken by the United States to comply with the recommendations and rulings of the DSB after the original FSC measure was found to be WTO-inconsistent in *US – FSC*. (Appellate Body Report, *US – FSC*, para. 178) It is the same measure that the European Communities challenged in *US – FSC (Article 21.5 – EC)*, part of which the panel and Appellate Body found, in that dispute, to be inconsistent with the United States' WTO obligations. (Appellate Body Report, *US – FSC (Article 21.5 – EC)*, paras. 1 and 256(d)) Brazil acknowledges that, after the Panel Report was circulated, the "United States enacted legislation ... that seems to repeal most of the illegal aspects of the ETI Act of 2000". (Brazil's other appellant's submission, para. 214) Brazil is referring to the American Jobs Creation Act of 2004, enacted as Public Law 108-357.

subsidies to upland cotton within the meaning of Articles 3.1(a) and 3.2 of the *SCM Agreement*.<sup>1144</sup> Brazil pointed out that, in *US – FSC (Article 21.5 – EC)*, both the panel and Appellate Body found that the ETI Act of 2000 violates Articles 8 and 10.1 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement*. Brazil requested the Panel to apply the reasoning developed by that panel, as modified by the Appellate Body, *mutatis mutandis*, to this dispute.<sup>1145</sup>

736. The United States responded that the Panel should reject Brazil's claim because Brazil failed to make a *prima facie* case.<sup>1146</sup> According to the United States, "[a]s a result of Brazil's *mutatis mutandis*' approach, the Panel [was] in no position to exercise its judgment to follow, or decline to follow, prior dispute settlement findings concerning the ETI Act of 2000, nor even in a position to make factual findings concerning the Act".<sup>1147</sup>

737. The Panel began its analysis by noting that, apart from referring the Panel to the European Communities' claims and arguments in *US – FSC (Article 21.5 – EC)*, Brazil had submitted no direct evidence reflecting the nature, function or WTO-inconsistency of the ETI Act of 2000.<sup>1148</sup> It then observed that Brazil appeared to:

... seek a Panel process whereby we would simply apply the reasoning, and findings and conclusions of the panel, as modified by the Appellate Body, in the *US – FSC (Article 21.5 – EC)* dispute, without going through the ordinary procedural steps constituting panel proceedings set out in the *DSU*, including the examination of the legal claims against the measures constituting the matter before this Panel on the basis of direct evidence and argumentation submitted by the complaining and defending parties in this dispute. While Brazil has supplemented the evidence and argumentation in that dispute, it has not purported directly to establish the elements comprising the basis of the findings and conclusions in that dispute.<sup>1149</sup>

<sup>1144</sup>Panel Report, para. 7.950. (footnote omitted) Brazil explained that the subsidies granted to upland cotton under the ETI Act of 2000 do not fully conform to Part V of the *Agreement on Agriculture* and, therefore, are not exempt from action under the *SCM Agreement* pursuant to Article 13(c) of the *Agreement on Agriculture*.

<sup>1145</sup>Panel Report, para. 7.949. (footnotes omitted) Brazil incorporated by reference into its submissions (i) the Panel Report in *US – FSC (Article 21.5 – EC)*, (ii) the Appellate Body Report in *US – FSC (Article 21.5 – EC)*, and (iii) all submissions of the European Communities in that case. Brazil contends that an approach whereby the complaining Member incorporates by reference the reasoning of another panel, as modified by the Appellate Body, is consistent with the Appellate Body's reasoning in *Mexico – Corn Syrup (Article 21.5 – US)*. (Brazil's other appellant's submission, para. 224 (referring to Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 109))

<sup>1146</sup>Panel Report, para. 7.951.

<sup>1147</sup>*Ibid.*

<sup>1148</sup>*Ibid.*, para. 7.959.

<sup>1149</sup>Panel Report, para. 7.961. (footnotes omitted)

The Panel saw "no basis in the text of the DSU ... for such incorporation by reference of claims and arguments made in a previous dispute nor for a quasi-automatic application of findings, recommendations and rulings from a previous dispute".<sup>1150</sup> In addition, the Panel rejected Brazil's reliance on Article 17.14 of the DSU<sup>1151</sup> to support its claim, reasoning that, because Brazil was not a party in *US – FSC (Article 21.5 – EC)*, the panel and Appellate Body reports in that case "cannot be taken as a providing a final resolution to the part of the matter before [it] concerning the ETI Act of 2000".<sup>1152</sup>

738. The Panel then identified other differences between the present dispute and *US – FSC (Article 21.5 – EC)*.<sup>1153</sup> These differences meant, according to the Panel, that the evidence and argumentation relating to the present dispute are distinct from those in *US – FSC (Article 21.5 – EC)*.<sup>1154</sup> The differences in the evidence and argumentation, in turn, led the Panel to decide that "no direct transposition or incorporation of the panel and Appellate Body findings and conclusions would, in any event, be appropriate on the basis of the evidence and argumentation submitted in this dispute".<sup>1155</sup> Moreover, the Panel observed that, in a written communication to the parties after the first meeting, it had "put Brazil on notice that the evidence and arguments submitted up to that point in the Panel proceedings did not provide sufficient basis for [the Panel] to make a finding".<sup>1156</sup>

<sup>1150</sup>*Ibid.*, para. 7.962.

<sup>1151</sup>Article 17.14 of the DSU provides:

An Appellate Body report shall be adopted by the DSB and unconditionally accepted by the parties to the dispute unless the DSB decides by consensus not to adopt the Appellate Body report within 30 days following its circulation to the Members. (footnote omitted)

<sup>1152</sup>Panel Report, para. 7.967. (footnote omitted)

<sup>1153</sup>The Panel explained that, in *US – FSC (Article 21.5 – EC)*, the claims under the *SCM Agreement* were examined before those under the *Agreement on Agriculture*, an order contrary to that adopted by the Panel in this case. (Panel Report, para. 7.971) Also, the Panel pointed out that, in *US – FSC (Article 21.5 – EC)*, there was no discussion relating to issues under Article 13 of the *Agreement on Agriculture*. (Panel Report, para. 7.972) Finally, the Panel observed that the findings in *US – FSC (Article 21.5 – EC)* were not specific to upland cotton. (Panel Report, para. 7.973)

<sup>1154</sup>*Ibid.*, para. 7.975.

<sup>1155</sup>*Ibid.*

<sup>1156</sup>Panel Report, para. 7.980. The written communication is dated 5 September 2003 and in it the Panel "indicated to the parties that, on the basis of the evidence and arguments presented to date, it is unable to form any view on whether the ETI Act of 2000 satisfies the relevant provisions of the *Agreement on Agriculture*".

The Panel also referred to "its discretionary authority to put questions to the parties to clarify the factual and legal aspects of the matter". (*Ibid.*, para. 7.983) In this respect, the Panel explained that its authority to ask questions or seek information is not conditional on a party having established a *prima facie* case. Nevertheless, the Panel observed that it was "not permitted to make Brazil's case for Brazil". (*Ibid.*, para. 7.985)

739. For these reasons, the Panel concluded:

[O]n the basis of the evidence and arguments submitted, we are not in a position to conclude that Brazil has established a *prima facie* case that the ETI Act of 2000 and subsidies granted thereunder are inconsistent with Articles 8 and 10.1 of the *Agreement on Agriculture* in respect of upland cotton.<sup>1157</sup>

740. On appeal, Brazil asserts that the Panel erred in the "interpretation and application of the burden of proof under Articles 8 and 10.1 of the *Agreement on Agriculture*, and Articles 3.1(a) and 3.2 of the *SCM Agreement*, in light of the goal of the WTO dispute settlement system, under Article 3.3 of the DSU, to provide for the 'prompt settlement' of disputes".<sup>1158</sup> Brazil submits that it challenged before the Panel exactly the same measure that the panel and the Appellate Body in *US – FSC (Article 21.5 – EC)* held violated the *Agreement on Agriculture* and the *SCM Agreement*. This measure had not changed since it was enacted in 2000<sup>1159</sup> and thus the legislation that forms the basis for the United States measure that is subject to Brazil's claims is identical to the legislation at issue in *US – FSC (Article 21.5 – EC)*.<sup>1160</sup> According to Brazil, the United States did not dispute the identity between the measures.<sup>1161</sup>

741. In addition, Brazil asserts that the United States never rebutted Brazil's arguments, or the supporting documents that Brazil referenced, that demonstrate the inconsistency of the ETI Act of 2000 with Articles 8 and 10.1 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement*.<sup>1162</sup> Brazil refers to *Mexico – Corn Syrup (Article 21.5 – US)*, where the Appellate Body held that a panel may incorporate the reasoning of another panel by reference and still meet the requirement in Article 12.7 of the DSU to set out the "basic rationale" for its findings and conclusions.<sup>1163</sup> Brazil sees no reason why this reasoning should not also apply to submissions by a

<sup>1157</sup>*Ibid.*, para. 7.986. The Panel also concluded that:

... in accordance with Article 13(c)(ii) of the *Agreement on Agriculture*, to the extent that Brazil has not demonstrated that the United States ETI Act of 2000 is not in conformity with the United States export subsidy commitments under Part V of the *Agreement on Agriculture* in respect of upland cotton, the United States is "exempt from actions based on" Articles 3.1(a) and 3.2 of the *SCM Agreement*. We therefore decline to examine Brazil's claims based on those provisions.

(*Ibid.*, para. 7.987) (footnote omitted)

<sup>1158</sup>Brazil's other appellant's submission, para. 7.

<sup>1159</sup>Brazil notes that legislation "that seems to repeal most of the illegal aspects of the ETI Act of 2000" was enacted in 2004. (Brazil's other appellant's submission, para. 2.14) See *supra*, footnote 1143.

<sup>1160</sup>Brazil's other appellant's submission, para. 221.

<sup>1161</sup>*Ibid.*

<sup>1162</sup>Brazil's other appellant's submission, para. 222.

<sup>1163</sup>Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 109.

complaining Member that incorporate by reference the reasoning of another panel, as modified by the Appellate Body, addressing the exact same measure.<sup>1164</sup>

742. Brazil acknowledges that the "United States enacted legislation ... that seems to repeal most of the illegal aspects of the ETI Act of 2000".<sup>1165</sup> Consequently, Brazil expressly states that, were we to modify the Panels' "interpretation and application of the burden of proof"<sup>1166</sup>, it is not requesting us to complete the legal analysis and find that the export subsidies to upland cotton, provided under the ETI Act of 2000, are inconsistent with Articles 8 and 10.1 of *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement*.<sup>1167</sup>

743. The United States responds that we should not decide Brazil's appeal because Brazil acknowledges that the appeal is not necessary to resolve the dispute between the parties. Brazil explicitly does not ask the Appellate Body to complete the analysis with respect to its claims. The United States argues that the Appellate Body should abstain from deciding this issue because Brazil is not asking "the Appellate Body to make findings that would result in DSB rulings and recommendations with respect to the ETI Act".<sup>1168</sup> For that reason alone, the Appellate Body should decline to decide Brazil's appeal.<sup>1169</sup>

744. In any event, the United States submits that the Panel correctly concluded that Brazil did not make a *prima facie* case with respect to the ETI Act of 2000. Brazil simply did not present any evidence at all regarding the ETI Act of 2000 itself. According to the United States, the Panel acted properly under the text of the DSU, including Article 11, by declining to find that the "short shrift" that Brazil gave to the ETI Act of 2000 satisfied Brazil's burden to make its *prima facie* case concerning that Act.<sup>1170</sup>

745. At the outset, we observe that Article 17.6 of the DSU provides that appeals "shall be limited to issues of law covered in the panel report and legal interpretations developed by the panel". Furthermore, Article 17.12 of the DSU states that "[t]he Appellate Body shall address each of the

<sup>1164</sup>In addition, Brazil states that it submitted to the Panel arguments and evidence that addressed the specific nature of its claims, in particular with respect to Article 13(c)(ii) of the *Agreement on Agriculture* (Brazil's other appellant's submission, para. 225)

<sup>1165</sup>*Ibid.*, para. 214.

<sup>1166</sup>*Ibid.*, para. 7.

<sup>1167</sup>*Ibid.*, para. 214.

<sup>1168</sup>United States' appellee's submission, para. 100. The United States relies for support on the Appellate Body Reports in *US – Steel Safeguards* and *US – Wool Shirts and Blouses*.

<sup>1169</sup>United States' appellee's submission, para. 100.

<sup>1170</sup>United States' appellee's submission, para. 112.

issues raised in accordance with paragraph 6 during the appellate proceeding". The United States does not argue that Brazil has failed to appeal an issue of law or a legal interpretation. Thus, the United States is not asserting that Brazil could not have brought this claim on appeal or that we are legally precluded from addressing it. The United States' assertion is that it is not *necessary* for us to resolve Brazil's claim because Brazil is not requesting us to make findings that would result in DSB rulings and recommendations.

746. We agree. Article 3.3 of the DSU explains that the aim of the WTO's dispute settlement system is the "prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member". For its part, Article 3.4 of the DSU provides that "[r]ecommendations or rulings made by the DSB shall be aimed at achieving a satisfactory settlement of the matter". Similarly, Article 3.7 states that "[t]he aim of the dispute settlement mechanism is to secure a positive solution to a dispute". The Appellate Body, moreover, has cautioned that "[g]iven the explicit aim of dispute settlement that permeates the DSU, ... Article 3.2 of the DSU is [not] meant to encourage either panels or the Appellate Body to 'make law' by clarifying existing provisions of the *WTO Agreement* outside the context of resolving a particular dispute".<sup>1171</sup>

747. In this case, Brazil's claim on appeal is limited to the Panel's application of the burden of proof. Brazil has expressly stated that it is not requesting us to complete the analysis. In view of Brazil's request, our ruling would not result in recommendations or rulings by the DSB in respect of the ETI Act of 2000. In these circumstances, we fail to see how our examination of Brazil's claim would contribute to the "prompt" or "satisfactory settlement" of this matter or would contribute to "secure a positive solution" to this dispute.<sup>1172</sup> Even if we were to disagree with the manner in which the Panel applied the burden of proof, we would not make any findings in respect of the WTO-consistency of the ETI Act of 2000. We recognize that there may be cases in which it would be useful for us to make a finding on an issue, despite the fact that our decision would not result in rulings and recommendations by the DSB. In this case, however, we find no compelling reason for doing so on this particular issue.

<sup>1171</sup>Appellate Body Report, *US – Wool Shirts and Blouses*, p. 19, DSR 1997:1, 323 at 340.

748. For these reasons, we decline Brazil's request that we reverse the Panel's conclusion that Brazil did not make a *prima facie* case that the ETI Act of 2000 is inconsistent with the United States' WTO obligations. In declining to rule on Brazil's request, we neither endorse nor reject the manner in which the Panel applied the burden of proof in the context of examining Brazil's claim against the ETI Act of 2000.

I. *Interpretation of Article XVI:3 of the GATT 1994*

1. Introduction

749. Before the Panel, Brazil claimed that the United States applied its domestic and export subsidies to upland cotton during the 1999-2002 marketing years in a manner that resulted in the United States having more than an equitable share of world export trade within the meaning of Article XVI:3 of the GATT 1994, and thereby caused serious prejudice within the meaning of Article XVI:1 of the GATT 1994.<sup>1173</sup>

750. In addressing this claim, the Panel considered whether paragraphs 1 and 3 of Article XVI could be considered together, to address both the domestic support and export subsidy measures at issue. The Panel said that "we do not believe that these provisions are susceptible to such joint application", on the grounds that "each provision – Article XVI:1 and Article XVI:3 – requires application in accordance with its own terms in respect of measures that fall within its respective scope of application".<sup>1174</sup>

751. The Panel dealt with Brazil's allegation that the subsidies at issue resulted in the United States enjoying "more than an equitable share of world export trade" under Article XVI:3 of the GATT 1994

<sup>1173</sup>Our approach is consistent with the approach of the Appellate Body in *US – Steel Safeguards*, where it did not find it necessary to examine the Panel's findings on the causation analysis because it had "already found that the measures before [it] are inconsistent with Article XIX:1(a) of the GATT 1994 and with Articles 2.1, 3.1 and 4.2 of the *Agreement on Safeguards*". (Appellate Body Report, *US – Steel Safeguards*, para. 483)

The Appellate Body noted, in that appeal, that "several participants expressed an interest in having [it] rule on causation as it would provide guidance to Member on applying safeguard measures in the future consistently with their WTO obligations". (Appellate Body Report, *US – Steel Safeguards*, para. 484) Despite this request for guidance, the Appellate Body declined to make a ruling on this specific aspect of the case. (Appellate Body Report, *US – Steel Safeguards*, paras. 485-491)

<sup>1174</sup>Brazil's further submission to the Panel, para. 277.

<sup>1175</sup>Panel Report, para. 7.992. The Panel thus addressed elements of Brazil's claim in different parts of its Report. The Panel's response to Brazil's allegation of "serious prejudice" under Article XVI:1 of the GATT 1994 is dealt with in the section of the Panel Report addressing "Actionable Subsidies: Claims of 'Present Serious Prejudice'". (*ibid.*, Section VII:G) In the light of its findings of present serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*, the Panel exercised judicial economy with respect to Brazil's claim of serious prejudice under Article XVI:1 of the GATT 1994. (*ibid.*, para. 7.1476)

in the section of the Panel Report dealing with "Export Subsidies".<sup>1175</sup> The Panel examined whether Article XVI:3 applies only to export subsidies, or whether it also applied to all of the types of subsidies covered by Article XVI:1 as well. The Panel found that:

Article XVI:3 applies only to export subsidies as that term is now defined in the *Agreement on Agriculture* and the *SCM Agreement*.<sup>1176</sup>

752. Because the Panel had concluded that Step 2 payments to exporters and export credit guarantees under the GSM 102, GSM 103 and SCGP programs constituted export subsidies prohibited by the relevant provisions of the *Agreement on Agriculture* and the *SCM Agreement*, the Panel—as it had done in respect of Brazil's claims under Article XVI:1 of the GATT 1994—exercised judicial economy with respect to Brazil's claim under Article XVI:3 of the GATT 1994.<sup>1177</sup>

753. Brazil's appeal regarding the Panel's findings with respect to the application of Article XVI:3 of the GATT 1994 has two elements. First, Brazil appeals the Panel's finding that Article XVI:3 applies only to export subsidies as that term is now defined in the *Agreement on Agriculture* and the *SCM Agreement*. Brazil stresses that its appeal in this regard, that is, the Panel's legal interpretation of the second sentence of Article XVI:3 of the GATT 1994, is *not conditional*.<sup>1178</sup> Brazil argues that, in reaching the view that Article XVI:3 applies only to export subsidies, as currently defined in the *SCM Agreement* and the *Agreement on Agriculture*, the Panel misinterpreted the second sentence of Article XVI:3, which establishes disciplines upon "any form of subsidy which operates to increase the export of any primary product", that is, all subsidies that have an export-enhancing effect, and not just subsidies that are contingent on export performance. According to Brazil, the focus of Article XVI:3 is upon the effect of subsidies in enhancing exports, and not upon formal distinctions between export contingent and other subsidies.<sup>1179</sup>

754. Secondly, Brazil *conditionally* requests the Appellate Body to complete the analysis of its claim that United States price-contingent subsidies<sup>1180</sup> result in the United States having a "more than equitable share of world export trade" in upland cotton, in violation of Article XVI:3, second sentence.<sup>1181</sup> Brazil's request to complete the analysis is conditional upon two events: (i) a reversal by

<sup>1175</sup>*Ibid.*, Section VII:E.

<sup>1176</sup>*Ibid.*, para. 7.1016.

<sup>1177</sup>*Ibid.*, para. 7.1017.

<sup>1178</sup>Brazil's other appellant's submission, para. 319.

<sup>1179</sup>Brazil's other appellant's submission, paras. 323-327.

<sup>1180</sup>That is, marketing loan payments, Step 2 payments, market loss assistance payments and counter-cyclical payments.

<sup>1181</sup>Brazil's other appellant's submission, para. 318.

the Appellate Body of the Panel's finding regarding *significant price suppression* (resulting in serious prejudice in terms of Articles 6.3(c) and 5(c) of the *SCM Agreement*); and, (ii) denial by the Appellate Body of Brazil's request for a ruling that the United States' measures at issue resulted in an increase of the United States' *world market share* in upland cotton (resulting in serious prejudice in terms of Articles 6.3(d) and 5(c) of the *SCM Agreement*).<sup>1182</sup> Brazil submits that there are sufficient factual findings by the Panel or undisputed facts on the record to allow the Appellate Body to complete the analysis of Brazil's claim regarding violation of Article XVI:3 by the United States price-contingent subsidies.<sup>1183</sup>

755. The United States emphasizes that the text of Article XVI distinguishes between "Subsidies in General" (Section A) and "Additional Provisions on Export Subsidies" (Section B). By locating Article XVI:3 in Section B, Members agreed that Article XVI:3 is a provision on export subsidies.<sup>1184</sup> The term "export subsidy" is now defined in the *SCM Agreement* and the *Agreement on Agriculture* as referring to subsidies that are contingent on export performance.<sup>1185</sup> Both the context provided by these Agreements, as well as their negotiating history, confirm that the export subsidies referred to in Article XVI:3 are also subsidies contingent on export performance.<sup>1186</sup>

756. With respect to Brazil's conditional request to complete the analysis, the United States contends that, even if the Appellate Body reverses the Panel's interpretation regarding the scope of Article XVI:3, there would be insufficient undisputed facts on the record or factual findings by the Panel to complete the analysis. The United States observes that the Panel did not make any findings on causation relative to trade shares. Nor has Brazil put forward a tenable standard for assessing what is more than an "equitable" trade share.<sup>1187</sup>

## 2. Analysis

757. Article XVI of the GATT 1994 contains two sections. "Section A" lays down certain rules for "Subsidies in General". "Section B", containing paragraphs 2-5 of Article XVI, provides "Additional Provisions on Export Subsidies". In Article XVI:2, the Members "recognize" that the

<sup>1182</sup>*Ibid.*, para. 319. We observe that Brazil does *not appeal* the Panel's findings with regard to Article XVI:1 and the relationship between Articles XVI:1 and XVI:3 (Panel Report, paras. 7.1470-7.1476), and does not appear to rely to any great extent on Article XVI:1 in its arguments relating to this part of its appeal.

<sup>1183</sup>Brazil's other appellant's submission, paras. 371-379.

<sup>1184</sup>United States' appellee's submission, para. 167.

<sup>1185</sup>*Ibid.*, para. 168.

<sup>1186</sup>*Ibid.*, paras. 169-180.

<sup>1187</sup>United States' appellee's submission, paras. 181-187.

provision of "a subsidy on the export of any product may have harmful effects ...". Article XVI:3, the provision at issue in this part of Brazil's appeal, sets forth that "[a]ccordingly":

Members should seek to avoid the use of subsidies on the export of primary products. *If, however, a Member grants directly or indirectly any form of subsidy which operates to increase the export of any primary product from its territory, such subsidy shall not be applied in a manner which results in that Member having more than an equitable share of world export trade in that product, account being taken of the shares of the Members in such trade in the product during a previous representative period, and any special factors which may have affected or may be affecting such trade in the product.\* (ad note omitted; emphasis added)*

758. The Panel found "that Article XVI:3 applies only to export subsidies as that term is now defined in the *Agreement on Agriculture* and the *SCM Agreement*".<sup>1188</sup> In the light of its rulings under the *Agreement on Agriculture* and the *SCM Agreement* with regard to the United States' export subsidies at issue in the proceedings, the Panel exercised judicial economy with respect to Brazil's claims under Article XVI:3 of the GATT 1994.<sup>1189</sup>

759. Brazil's appeal of these findings has two elements. First, Brazil's appeal focuses on the phrase "any form of subsidy which operates to increase the export of any primary product". It argues that the ordinary meaning of this phrase encompasses all subsidies with an export-enhancing effect, not just those that are *contingent* on export performance. Second, Brazil requests the Appellate Body to complete the analysis and find that the United States' price-contingent subsidies violate Article XVI:3, second sentence, *conditional* upon two events: reversal by the Appellate Body of the Panel's finding of significant price suppression and serious prejudice within the meaning of Articles 6.3(c) and 5(c) of the *SCM Agreement*, as well as denial, by the Appellate Body, of Brazil's appeal concerning the interpretation and application of Articles 6.3(d) and 5(c) of the *SCM Agreement*.

760. With respect to the second element of Brazil's appeal, we note that, above, we upheld the Panel's finding that the effect of the price-contingent subsidies at issue in these proceedings is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*.<sup>1190</sup> We observe, therefore, that the initial condition upon which Brazil's request to complete the analysis of this claim rests is *not* made out, and thus there is no need for us to complete the analysis and to examine whether or not the United States subsidies challenged by Brazil resulted in the United States having more than an equitable share of world export trade in upland cotton.

<sup>1188</sup>Panel Report, para. 7.1016.

<sup>1189</sup>*Ibid.*, para. 7.1017

<sup>1190</sup>*Supra*, para. 496.

761. Nor do we believe that it is necessary to make a finding on the interpretation of the phrase "any form of subsidy which operates to increase the export of any primary product" in the second sentence of Article XVI:3 of the GATT 1994 in order to resolve this dispute. Given our ruling under Article 6.3(c) of the *SCM Agreement*, we observe that, although any ruling by the Appellate Body on the scope of the subsidies covered by Article XVI:3 of the GATT 1994 in the abstract might at best offer some degree of "guidance", it would not affect the resolution of this dispute.<sup>1191</sup> Indeed, irrespective of whether we were to uphold or reverse the Panel's finding on this issue, upon adoption of the recommendations and rulings by the DSB, the United States would be under no additional obligation regarding implementation. Thus, although we recognize that there may be cases in which it would be useful for us to make a finding on an issue, despite the fact that our finding would not result in recommendations and rulings by the DSB, we find no compelling reason for doing so in this case in respect of this particular issue.

762. We therefore believe that an interpretation of the phrase "any form of subsidy which operates to increase the export" in Article XVI:3 of the GATT 1994 is unnecessary for purposes of resolving this dispute. We emphasize that we neither uphold nor reverse the Panel's interpretation of this phrase in the second sentence of Article XVI:3.

### VIII. Findings and Conclusions

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

- (a) as regards procedural matters:
- (i) in relation to production flexibility contract payments and market loss assistance payments:
  - upholds the Panel's finding, in paragraphs 7.118, 7.122, 7.128, and 7.194(ii) of the Panel Report, that Articles 4.2 and 6.2 of the DSU do not exclude expired measures from the potential scope of consultations or a request for establishment of a panel and, therefore, that production flexibility contract payments and market loss assistance payments fell within the Panel's terms of reference; and
  - finds that the Panel set out the findings of fact, the applicability of relevant provisions, and the basic rationale behind this finding, as required by Article 12.7 of the DSU; and
- (ii) in relation to export credit guarantee programs:
- upholds the Panel's ruling, in paragraph 7.69 of the Panel Report, that "export credit guarantees to facilitate the export of United States upland cotton, and other eligible agricultural commodities ... are within its terms of reference"; and
  - upholds the Panel's ruling, in paragraph 7.103 of the Panel Report, that "Brazil provided a statement of available evidence with respect to export credit guarantee measures relating to upland cotton and eligible United States agricultural products other than upland cotton, as required by Article 4.2 of the *SCM Agreement*";
- (b) as regards the application of Article 13 of the *Agreement on Agriculture* to this dispute:
- (i) in relation to Article 13(a)(ii):
  - upholds the Panel's finding, in paragraphs 7.388, 7.413, 7.414, and 8.1(b) of the Panel Report, that production flexibility contract

<sup>1191</sup>We note in this regard that, in *US – Steel Safeguards*, the Appellate Body noted that "several participants expressed an interest in having [it] rule on causation as it would provide guidance to Members on applying safeguard measures in the future consistently with their WTO obligations". (*Appellate Body Report, US – Steel Safeguards*, para. 484) (original emphasis) Despite this request for guidance, the Appellate Body declined to make a ruling on this specific aspect of the case. (*Appellate Body Report, US – Steel Safeguards*, paras. 485-491)

payments and direct payments are not green box measures that fully conform to paragraph 6(b) of Annex 2 of the *Agreement on Agriculture*; and, therefore, are not exempt from actions under Article XVI of GATT 1994 and Part III of the *SCM Agreement* by virtue of Article 13(a)(ii) of the *Agreement on Agriculture*; and

- declines to rule on Brazil's conditional request that the Appellate Body find that the updating of base acres for direct payments under the FSRI Act of 2002 means that direct payments are not green box measures that fully conform to paragraph 6(a) of Annex 2 of the *Agreement on Agriculture*; and, therefore, are not exempt from actions under Article XVI of GATT 1994 and Part III of the *SCM Agreement* by virtue of Article 13(a)(ii) of the *Agreement on Agriculture*; and

(ii) in relation to Article 13(b)(ii):

- modifies the Panel's interpretation, set out in paragraph 7.494 of the Panel Report, of the phrase "support to a specific commodity" in Article 13(b)(ii) of the *Agreement on Agriculture*; but upholds the Panel's finding, in paragraphs 7.518 and 7.520 of the Panel Report, that Step 2 payments to domestic users, marketing loan program payments, production flexibility contract payments, market loss assistance payments, direct payments, counter-cyclical payments, crop insurance payments, and cottonseed payments (the "challenged domestic support measures") granted "support to a specific commodity", namely, upland cotton;

- declines to rule on the United States' appeal that only the price gap methodology described in paragraph 10 of Annex 3 of the *Agreement on Agriculture* may be used to measure the value of marketing loan program payments and deficiency payments for the purposes of the comparison required by Article 13(b)(ii) of the *Agreement on Agriculture*; and

- upholds the Panel's finding, in paragraphs 7.608 and 8.1(c) of the Panel Report, that the "challenged domestic support measures"

granted, in the years 1999, 2000, 2001 and 2002, support to a specific commodity, namely, upland cotton, in excess of that decided during the 1992 marketing year; and, therefore, that these measures are not exempt from actions based on Articles 5 and 6 of the *SCM Agreement* and Article XVI:1 of the GATT 1994 by virtue of Article 13(b)(ii) of the *Agreement on Agriculture*;

(c) as regards serious prejudice:

(i) in relation to Article 6.3(c) of the *SCM Agreement*:

- upholds the Panel's finding, in paragraphs 7.1416 and 8.1(g)(i) of the Panel Report, that the effect of the marketing loan program payments, Step 2 payments, market loss assistance payments, and counter-cyclical payments (the "price-contingent subsidies") is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*, by in turn upholding the Panel's findings:

(A) regarding the "market" and "price" in assessing whether "the effect of the subsidy is ... significant price suppression ... in the same market" within the meaning of Article 6.3(c) of the *SCM Agreement*:

- in paragraphs 7.1238-7.1240 of the Panel Report, that the "same market" may be a "world market";
- in paragraph 7.1247 of the Panel Report, that a "world market" for upland cotton exists; and
- in paragraph 7.1274 of the Panel Report, that "the A-Index can be taken to reflect a world price in the world market for upland cotton"; and

(B) regarding the "effect" of the price-contingent subsidies under Article 6.3(c) of the *SCM Agreement*:

- in paragraphs 7.1312 and 7.1333 of the Panel Report, that "significant price suppression" occurred within the meaning of Article 6.3(c);

- in paragraphs 7.1355 and 7.1363 of the Panel Report, that "a causal link exists" between the price-contingent subsidies and the significant price suppression found by the Panel under Article 6.3(c) and that this link is not attenuated by other factors raised by the United States;

- in paragraphs 7.1173, 7.1186, and 7.1226 of the Panel Report, that it was not required to quantify precisely the benefit conferred on upland cotton by the price-contingent subsidies and, consequently, not identifying the precise amount of counter-cyclical payments and market loss assistance payments that benefited upland cotton; and

- in paragraph 7.1416 of the Panel Report, that the effect of the price-contingent subsidies for marketing years 1999 to 2002 "is significant price suppression ... in the period MY 1999-2002"; and

- finds that the Panel, as required by Article 12.7 of the DSU, set out the findings of fact, the applicability of relevant provisions, and the basic rationale behind its finding, in paragraphs 7.1416 and 8.1(g)(i) of the Panel Report, that the effect of the price-contingent subsidies is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*; and

(ii) in relation to Article 6.3(d) of the *SCM Agreement*:

- finds it unnecessary, for the purposes of resolving this dispute, to rule on the interpretation of the phrase "world market share" in Article 6.3(d) of the *SCM Agreement*, and neither upholds nor reverses the Panel's findings in this regard; and

- declines to rule on Brazil's conditional request for the Appellate Body to find that the effect of the price-contingent subsidies is an

increase in the United States' world market share in upland cotton within the meaning of Article 6.3(d) of the *SCM Agreement*;

(d) as regards user marketing (Step 2) payments:

(i) upholds the Panel's findings, in paragraphs 7.1088, 7.1097-7.1098, and 8.1(f) of the Panel Report, that Step 2 payments to *domestic users* of United States upland cotton, under Section 1207(a) of the FSRI Act of 2002, are subsidies contingent on the use of domestic over imported goods that are inconsistent with Articles 3.1(b) and 3.2 of the *SCM Agreement*; and

(ii) upholds the Panel's findings, in paragraphs 7.748-7.749, 7.760-7.761, and 8.1(e) of the Panel Report, that Step 2 payments to *exporters* of United States upland cotton, pursuant to Section 1207(a) of the FSRI Act of 2002, are subsidies contingent upon export performance within the meaning of Article 9.1(a) of the *Agreement on Agriculture* that are inconsistent with Articles 3.3 and 8 of that Agreement and Articles 3.1(a) and 3.2 of the *SCM Agreement*;

(e) as regards export credit guarantee programs:

(i) upholds the Panel's finding, in paragraphs 7.901, 7.911, and 7.932 of the Panel Report, that Article 10.2 of the *Agreement on Agriculture* does not exempt export credit guarantees from the export subsidy disciplines in Article 10.1 of that Agreement<sup>1192</sup>;

(ii) finds that the Panel did not improperly apply the burden of proof in finding that the United States' export credit guarantee programs are prohibited export subsidies under Article 3.1(a) of the *SCM Agreement* and are consequently inconsistent with Article 3.2 of that Agreement;

(iii) declines to find that the Panel erred by failing to make the necessary findings of fact in assessing whether the export credit guarantee programs are provided at premium rates that are inadequate to cover long-term operating costs and losses within the meaning of item (j) of the Illustrative List of Export Subsidies annexed to the *SCM Agreement*; and, consequently,

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<sup>1192</sup>See Separate Opinion, *supra*, paras. 631-641.

(iv) upholds the Panel's finding, in paragraph 7.869 of the Panel Report, that "the United States export credit guarantee programmes at issue—GSM 102, GSM 103 and SCGP—constitute a *per se* export subsidy within the meaning of item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*", and upholds the Panel's findings, in paragraphs 7.947 and 7.948 of the Panel Report, that these export credit guarantee programs are export subsidies for purposes of Article 3.1(a) of the *SCM Agreement* and are inconsistent with Articles 3.1(a) and 3.2 of that Agreement; and

(v) finds that the Panel did not err in exercising judicial economy in respect of Brazil's allegation that the United States' export credit guarantee programs are prohibited export subsidies, under Article 3.1(a) of the *SCM Agreement*, because they confer a "benefit" within the meaning of Article 1.1 of that Agreement;

(f) as regards circumvention of export subsidy commitments:

(i) reverses the Panel's finding, in paragraph 7.881 of the Panel Report, that Brazil did not establish actual circumvention in respect of poultry meat and pig meat; finds, however, that there are insufficient uncontested facts in the record to complete the legal analysis to determine whether the United States' export credit guarantees to poultry meat and pig meat have been applied in a manner that "results in" circumvention of the United States' export subsidy commitments, within the meaning of Article 10.1 of the *Agreement on Agriculture*;

(ii) modifies the Panel's interpretation, in paragraphs 7.882-7.883 and 7.896 of the Panel Report, of the phrase "threatens to lead to .... circumvention" in Article 10.1 of the *Agreement on Agriculture* to the extent that the Panel's interpretation requires "an unconditional legal entitlement" to receive the relevant export subsidies as a condition for a finding of threat of circumvention, but upholds, for different reasons, the Panel's finding, in paragraph 7.896 of the Panel Report, that Brazil has not established that "the export credit guarantee programmes at issue are generally applied to scheduled agricultural products other than rice and other unscheduled agricultural products (not supported under the programmes) in a manner which threatens to lead to circumvention of United States export subsidy

commitments within the meaning of Article 10.1 of the *Agreement on Agriculture*"; and

(iii) finds that the Panel did not err in confining its examination of Brazil's threat of circumvention claim to scheduled products other than rice and unscheduled products not supported under the United States' export credit guarantee programs;

(g) as regards the ETI Act of 2000, declines Brazil's request that the Appellate Body reverse the Panel's conclusion that Brazil did not make a *prima facie* case that the ETI Act of 2000 is inconsistent with the United States' WTO obligations; and

(h) as regards Article XVI:3 of the GATT 1994:

(i) finds it unnecessary, for the purposes of resolving this dispute, to rule on the interpretation of the phrase "any form of subsidy which operates to increase the export" in Article XVI:3 of the GATT 1994, and neither upholds nor reverses the Panel's findings in this regard; and

(ii) declines to rule on Brazil's conditional request for the Appellate Body to find that the price-contingent subsidies cause the United States to have "more than an equitable share of world export trade" in upland cotton, in violation of the second sentence of Article XVI:3 of the GATT 1994.

764. The Appellate Body recommends that the Dispute Settlement Body request the United States to bring its measures, found in this Report and in the Panel Report as modified by this Report to be inconsistent with the *Agreement on Agriculture* and the *SCM Agreement*, into conformity with its obligations under those Agreements.

Signed in the original in Geneva this 10th day of February 2005 by:

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Merit E. Janow  
Presiding Member

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Luitz Olavo Baptista  
Member

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A. V. Ganesan  
Member

ANNEX 1

**WORLD TRADE  
ORGANIZATION**

WT/DS267/17  
20 October 2004

(04-4441)

Original: English

**UNITED STATES – SUBSIDIES ON UPLAND COTTON**

Notification of an Appeal by the United States  
under paragraph 4 of Article 16 of the Understanding on Rules  
and Procedures Governing the Settlement of Disputes ("DSU")

The following notification, dated 18 October 2004, from the Delegation of the United States, is being circulated to Members.

Pursuant to Article 16 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") and Rule 20 of the Working Procedures for Appellate Review, the United States hereby notifies its decision to appeal to the Appellate Body certain issues of law covered in the Report of the Panel on *United States – Subsidies on Upland Cotton* (WT/DS267/R) and certain legal interpretations developed by the Panel in this dispute.

1. The United States seeks review by the Appellate Body of the Panel's legal conclusion that certain U.S. decoupled income support measures – that is, production flexibility contract payments under the Federal Agricultural Improvement and Reform Act of 1996 ("1996 Act"), direct payments under the Farm Security and Rural Investment Act of 2002 ("2002 Act"), and "the legislative and regulatory provisions which establish and maintain the [direct payments] programme" – are not exempt from actions under Article 13(a) of the *Agreement on Agriculture*.<sup>1</sup> This conclusion is in error and is based on erroneous findings on issues of law and related legal interpretations. These erroneous findings include, for example, that these decoupled income support measures do not conform to Annex 2.

2. The United States seeks review by the Appellate Body of the Panel's legal conclusion that certain U.S. domestic support measures<sup>2</sup> are not exempt from actions under Article 13(b) of the *Agreement on Agriculture*.<sup>3</sup> This conclusion is in error and is based on erroneous findings on issues of law and related legal interpretations. These erroneous findings include, for example, the Panel's finding that the challenged U.S. measures granted support to a specific commodity in excess of that decided in marketing year 1992 and therefore breached the proviso of Article 13(b) in each year from marketing year 1999-2002.

<sup>1</sup>See, e.g., Panel Report, paras. 8.1(b), 7.337-7.414.

<sup>2</sup>See Panel Report, para. 7.337.

<sup>3</sup>See, e.g., Panel Report, paras. 8.1(c), 7.415-7.647.

3. The United States seeks review by the Appellate Body of the Panel's legal conclusion that U.S. export credit guarantees under the GSM 102, GSM 103, and SCGP export credit guarantee programs in respect of unscheduled agricultural products supported under the programs and one scheduled commodity (rice) are "export subsidies applied in a manner which results in circumvention of United States export subsidy commitments, within the meaning of Article 10.1 of the *Agreement on Agriculture*," are therefore inconsistent with Article 8 of the *Agreement on Agriculture*, and are not exempt from actions under Article 13(c) of the *Agreement on Agriculture*.<sup>4</sup> This conclusion is in error and is based on erroneous findings on issues of law and related legal interpretations. These erroneous findings include, for example, the Panel's finding that export credit guarantees, notwithstanding Article 10.2 of the *Agreement on Agriculture*, constitute measures subject to Article 10.1 of the *Agreement on Agriculture*.

4. The United States seeks review by the Appellate Body of the Panel's legal conclusion that U.S. export credit guarantees under the GSM 102, GSM 103, and SCGP export credit guarantee programs in respect of other scheduled agricultural products constitute export subsidies within the meaning of Article 10.1 of the *Agreement on Agriculture*.<sup>5</sup> This conclusion is in error and is based on erroneous findings on issues of law and related legal interpretations. These erroneous findings include, for example, the Panel's finding that export credit guarantees, notwithstanding Article 10.2 of the *Agreement on Agriculture*, constitute measures subject to Article 10.1 of the *Agreement on Agriculture*.

5. The United States seeks review by the Appellate Body of the Panel's legal conclusion that U.S. export credit guarantees under the GSM 102, GSM 103, and SCGP export credit guarantee programs in respect of unscheduled agricultural products supported under the programs and one scheduled commodity (rice) are *per se* export subsidies prohibited by Articles 3.1(a) and 3.2 of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement").<sup>6</sup> This conclusion is in error and is based on erroneous findings on issues of law and related legal interpretations. These erroneous findings include, for example, the Panel's finding that the program for each product constitutes an export subsidy for purposes of the WTO Agreements and is provided by the United States at premium rates which are inadequate to cover long-term operating costs and losses of the programs within the meaning of item (j) of the Illustrative List of Export Subsidies in Annex I of the SCM Agreement.

6. The United States seeks review by the Appellate Body of the Panel's legal conclusion that section 1207(a) of the 2002 Act, which provides for user marketing (Step 2) payments to exporters of upland cotton, is an export subsidy that is listed in Article 9.1(a) of the *Agreement on Agriculture* that is inconsistent with U.S. obligations under Articles 3.3 and 8 of the *Agreement on Agriculture*, is not exempt from actions under Article 13(c) of the *Agreement on Agriculture*, and is inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement.<sup>7</sup> This conclusion is in error and is based on erroneous findings on issues of law and related legal interpretations. These erroneous findings include, for example, the Panel's finding that payments under the user marketing (Step 2) program are contingent on export performance.

7. The United States seeks review by the Appellate Body of the Panel's legal conclusion that section 1207(a) of the 2002 Act providing for user marketing (Step 2) payments to domestic users of upland cotton is an import substitution subsidy prohibited under Articles 3.1(b) and 3.2 of the

<sup>4</sup>See, e.g., Panel Report, paras. 8.1(d)(1), 7.762-7.945.

<sup>5</sup>See, e.g., Panel Report, paras. 8.1(d)(2), 7.762-7.945.

<sup>6</sup>See, e.g., Panel Report, paras. 8.1(d)(1), 7.787-7.869, 7.946-7.948.

<sup>7</sup>See, e.g., Panel Report, paras. 7.678-7.761, 8.1(c).

*Agreement on Subsidies and Countervailing Measures*.<sup>8</sup> This conclusion is in error and is based on erroneous findings on issues of law and related legal interpretations. These erroneous findings include, for example, the Panel's finding that domestic support payments that are consistent with a Member's domestic support reduction commitments under the *Agreement on Agriculture* may nonetheless be prohibited under the SCM Agreement.

8. The United States seeks review by the Appellate Body of the Panel's legal conclusion that "the effect of the mandatory, price contingent United States subsidies at issue – that is, marketing loan programme payments, user marketing (Step 2) payments and MLA payments and CCP payments – is significant price suppression in the same world market for upland cotton in the period MY 1999-2002 within the meaning of Articles 6.3(c) and 5(c)" of the SCM Agreement.<sup>9</sup> This conclusion is in error and is based on erroneous findings on issues of law and related legal interpretations. These erroneous findings include, for example, the following:

- (a) the Panel's finding that Brazil need not demonstrate, and the Panel need not find, the amount of the challenged subsidy that benefits the subsidized product, upland cotton;
- (b) the Panel's finding that subsidies not directly tied to current production of upland cotton (decoupled payments) need not be allocated to all products produced and sold by the firms receiving such subsidies;
- (c) that the Panel could make findings concerning subsidies that no longer existed at the time of panel establishment and that present serious prejudice could be, and was, caused by such subsidies;
- (d) the Panel's finding that the challenged subsidies provided to cotton producers "passed through" to cotton exporters;
- (e) the Panel's finding that there was price suppression "in the same market";
- (f) the Panel's finding that significant price suppression existed;
- (g) the Panel's finding that the price suppression it found under an erroneous legal standard was "significant";
- (h) the Panel's finding that "the effect of" the U.S. subsidies "is" significant price suppression;
- (i) the Panel's finding that "significant price suppression" is sufficient to establish "serious prejudice" for purposes of Articles 5(c) and 6.3 of the SCM Agreement; and
- (j) the Panel's finding that its "present" serious prejudice findings include findings of inconsistency that deal with the FSRI Act of 2002 and subsidies granted thereunder in MY 2002.<sup>10</sup>

9. The United States seeks review by the Appellate Body of the Panel's finding that decoupled payments made with respect to non-upland cotton base acres were within its terms of reference.<sup>11</sup> This finding is in error and is based on erroneous findings on issues of law and related legal

<sup>8</sup>See, e.g., Panel Report, paras. 7.1018-7.1098, 8.1(f).

<sup>9</sup>Panel Report, paras. 7.1416, 7.1107-7.1416, 8.1(g)(i).

<sup>10</sup>See, e.g., Panel Report, para. 7.1501.

<sup>11</sup>See, e.g., Panel Report, paras. 7.129-7.136.

interpretations. These erroneous findings include, for example, the Panel's finding that these payments were measures at issue within the meaning of Articles 4.4 and 6.2 of the DSU.

10. The United States requests the Appellate Body to find that the Panel failed to set out the findings of fact, the applicability of the relevant provisions, and the basic rationale behind its findings and recommendations, as required by Article 12.7 of the DSU. The Panel's failure to set these out include, for example, the findings or lack of findings concerning the following areas: the amount of the challenged subsidies, including the amount of payments not directly tied to current production of upland cotton (decoupled payments); that significant price suppression existed: the degree of price suppression it deemed "significant"; that "the effect of" the U.S. subsidies "is" significant price suppression; that decoupled payments made with respect to non-upland cotton base acres were within its terms of reference; and the basis for its ability to make findings with respect to subsidies that no longer existed at the time of panel establishment.

11. The United States seeks review by the Appellate Body of the Panel's finding that export credit guarantees to facilitate the export of "other eligible agricultural commodities" besides upland cotton were within its terms of reference.<sup>12</sup> This finding is in error and is based on erroneous findings on issues of law and related legal interpretations. These erroneous findings include, for example, the Panel's finding that such export credit guarantees were included in Brazil's consultation request and its finding that, contrary to Articles 4.2, 4.4, and 6.2 of the DSU, it could examine measures that were not included in Brazil's request for consultations.

12. The United States seeks review by the Appellate Body of the Panel's finding that Brazil provided the statement of available evidence required by Article 4.2 of the SCM Agreement with respect to export credit guarantee measures relating to eligible United States agricultural products other than upland cotton, and that accordingly, Brazil's claims concerning these measures were within the terms of reference of this dispute.<sup>13</sup> This finding is in error and is based on erroneous findings on issues of law and related legal interpretations.

13. In the event Brazil appeals the Panel's exercise of judicial economy with respect to Brazil's claims concerning the compatibility of U.S. export credit guarantee measures with Part III of the SCM Agreement,<sup>14</sup> in this U.S. appeal the United States conditionally requests the Appellate Body to find that Brazil also failed to provide a statement of available evidence as required by Article 7.2 of the SCM Agreement, and that accordingly, Brazil's claims concerning these measures would not be within the terms of reference of this dispute.

14. The United States seeks review by the Appellate Body of the Panel's legal conclusion that two types of expired measures, production flexibility contract payments and market loss assistance payments, were within the Panel's terms of reference. This conclusion is in error and is based on erroneous findings on issues of law and related legal interpretations. These erroneous findings include, for example, the Panel's finding that measures that are no longer in existence as of the date of establishment of a panel are nonetheless within a panel's terms of reference.<sup>15</sup>

<sup>12</sup>See, e.g., Panel Report, para. 7.69.

<sup>13</sup>See, e.g., Panel Report, para. 7.103.

<sup>14</sup>See, e.g., Panel Report, para. 7.78.

<sup>15</sup>See, e.g., Panel Report, para. 7.104-7.122.

ANNEX 2

Table 1: Comparison of Support for Purposes of Article 13(b)(ii) of the Agreement on Agriculture (using budgetary outlays for marketing loan program payments and deficiency payments)

\$ million	MY 1992	MY 1999	MY 2000	MY 2001	MY 2002
Step 2 payments (domestic users) *	102.7	165.8	260	144.8	72.4
Crop insurance payments *	26.6	169.6	161.7	262.9	194.1
Cottonseed payments *	0	79	184.7	0	50
PFC payments +	0	434.9	411.7	329.5	0
MLA payments +	0	432.8	438.3	452.3	0
DP payments +	0	0	0	0	391.8
CCP payments +	0	0	0	0	864.9
Marketing loan program *	866	1761	636	2609	897.8
Deficiency payments *	1017.4	0	0	0	0
<b>Total</b>	<b>2012.7</b>	<b>3043.1</b>	<b>2092.4</b>	<b>3798.5</b>	<b>2471</b>

Table 2: Comparison of Support for Purposes of Article 13(b)(ii) of the Agreement on Agriculture (using price gap methodology for marketing loan program payments and deficiency payments)

\$ million	MY 1992	MY 1999	MY 2000	MY 2001	MY 2002
Step 2 payments (domestic users) *	102.7	165.8	260	144.8	72.4
Crop insurance payments *	26.6	169.6	161.7	262.9	194.1
Cottonseed payments *	0	79	184.7	0	50
PFC payments +	0	434.9	411.7	329.5	0
MLA payments +	0	432.8	438.3	452.3	0
DP payments +	0	0	0	0	391.8
CCP payments +	0	0	0	0	864.9
Marketing loan program §	-84	-133	-136	-162	-130
Deficiency payments §	867	0	0	0	0
<b>Total</b>	<b>912.3</b>	<b>1149.1</b>	<b>1320.4</b>	<b>1027.5</b>	<b>1443.2</b>

Table 3: Values Attributable to the Price-Contingent Subsidies

\$ million	MY 1999	MY 2000	MY 2001	MY 2002
Marketing loan program *	1761	636	2609	897.8
Step 2 payments (domestic users & exporters) #	279.3	445.3	235.7	177.8
MLA payments +	432.8	438.3	452.3	0
CCP payments +	0	0	0	864.9
<b>Total</b>	<b>2473.1</b>	<b>1519.6</b>	<b>3297</b>	<b>1940.5</b>

Notes to Tables:

For the panel's findings regarding the values of support relevant for the analysis under Article 13(b)(ii) of the Agreement on Agriculture, see Panel Report, para. 7.596.

\* Panel Report, para. 7.596.

+ The values of production flexibility contract payments, market loss assistance payments, direct payments, and counter-cyclical payments are based on the "cotton to cotton" methodology, discussed *supra*, paras. 377-380. Figures are drawn from Panel Report, para. 7.641.

§ Panel Report, para. 7.564 and footnote 727 to para. 7.565.

# For the value of Step 2 payments to domestic users, see Panel Report, para. 7.596. To these figures we have added data submitted by the United States for the value of Step 2 payments to exporters: see United States' response to questions posed by the Panel, Panel Report, p. I-126, para. 211.



**World Trade Organization**

**Mexico – Tax Measures on Soft Drinks and Other Beverages**

**Report of the Appellate Body, 6 March 2006**

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**MEXICO – TAX MEASURES ON SOFT DRINKS  
AND OTHER BEVERAGES**

AB-2005-10

CASES CITED IN THIS REPORT

Short Title	Full Case Title and Citation
<i>Argentina – Poultry Anti-Dumping Duties</i>	Panel Report, <i>Argentina – Definitive Anti-Dumping Duties on Poultry from Brazil</i> , WT/DS241/R, adopted 19 May 2003, DSR 2003:V, 1727
<i>Australia – Salmon</i>	Appellate Body Report, <i>Australia – Measures Affecting Importation of Salmon</i> , WT/DS18/AB/R, adopted 6 November 1998, DSR 1998:VIII, 3327
<i>Canada – Aircraft</i>	Appellate Body Report, <i>Canada – Measures Affecting the Export of Civilian Aircraft</i> , WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377
<i>Canada – Wheat Exports and Grain Imports</i>	Appellate Body Report, <i>Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain</i> , WT/DS276/AB/R, adopted 27 September 2004
<i>Dominican Republic – Import and Sale of Cigarettes</i>	Appellate Body Report, <i>Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes</i> , WT/DS302/AB/R, adopted 19 May 2005
<i>EC – Bananas III</i>	Appellate Body Report, <i>European Communities – Regime for the Importation, Sale and Distribution of Bananas</i> , WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591
<i>EC – Export Subsidies on Sugar</i>	Appellate Body Report, <i>European Communities – Export Subsidies on Sugar</i> , WT/DS265/AB/R, WT/DS266/AB/R, WT/DS283/AB/R, adopted 19 May 2005
<i>EC – Hormones</i>	Appellate Body Report, <i>EC Measures Concerning Meat and Meat Products (Hormones)</i> , WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:1, 135
<i>India – Patents (US)</i>	Appellate Body Report, <i>India – Patent Protection for Pharmaceutical and Agricultural Chemical Products</i> , WT/DS50/AB/R, adopted 16 January 1998, DSR 1998:1, 9
<i>Korea – Various Measures on Beef</i>	Appellate Body Report, <i>Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef</i> , WT/DS161/AB/R, WT/DS169/AB/R, adopted 10 January 2001, DSR 2001:1, 5
<i>Mexico – Corn Syrup (Article 21.5 – US)</i>	Appellate Body Report, <i>Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States – Recourse to Article 21.5 of the DSU by the United States</i> , WT/DS132/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6675
<i>Mexico – Taxes on Soft Drinks</i>	Panel Report, <i>Mexico – Tax Measures on Soft Drinks and Other Beverages</i> , WT/DS308/R, 7 October 2005
<i>US – 1916 Act</i>	Appellate Body Report, <i>United States – Anti-Dumping Act of 1916</i> , WT/DS136/AB/R, WT/DS162/AB/R, adopted 26 September 2000, DSR 2000:X, 4793
<i>US – Corrosion-Resistant Steel Sunset Review</i>	Appellate Body Report, <i>United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan</i> , WT/DS244/AB/R, adopted 9 January 2004
<i>US – FSC (Article 21.5 – EC)</i>	Appellate Body Report, <i>United States – Tax Treatment for “Foreign Sales Corporations” – Recourse to Article 21.5 of the DSU by the European Communities</i> , WT/DS108/AB/RW, adopted 29 January 2002, DSR 2002:1, 55
<i>US – Gambling</i>	Appellate Body Report, <i>United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services</i> , WT/DS285/AB/R, adopted 20 April 2005
<i>US – Gasoline</i>	Appellate Body Report, <i>United States – Standards for Reformulated and Conventional Gasoline</i> , WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:1, 3

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<i>US – Section 337</i>	GATT Panel Report, <i>United States Section 337 of the Tariff Act of 1930</i> , adopted 7 November 1989, BISD 36S/345
<i>US – Shrimp</i>	Appellate Body Report, <i>United States – Import Prohibition of Certain Shrimp and Shrimp Products</i> , WT/DS58/AB/R, adopted 6 November 1998, DSR 1998:VII, 2755
<i>US – Shrimp (Article 21.5 – Malaysia)</i>	Appellate Body Report, <i>United States – Import Prohibition of Certain Shrimp and Shrimp Products – Recourse to Article 21.5 of the DSU by Malaysia</i> , WT/DS58/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6481
<i>US – Wool Shirts and Blouses</i>	Appellate Body Report, <i>United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India</i> , WT/DS33/AB/R and Corr.1, adopted 23 May 1997, DSR 1997:1, 323

ABBREVIATIONS USED IN THIS REPORT

Abbreviation	Description
Division	Appellate Body Division hearing this appeal
DSB	Dispute Settlement Body
DSU	<i>Understanding on Rules and Procedures Governing the Settlement of Disputes</i>
GATT 1994	<i>General Agreement on Tariffs and Trade 1994</i>
HFCS	high-fructose corn syrup
Inter-American Convention	Inter-American Convention for the Protection and Conservation of Sea Turtles
ITO	International Trade Organization
NAFTA	North American Free Trade Agreement
Panel	Panel in <i>Mexico – Taxes on Soft Drinks</i>
Panel Report	Panel Report, <i>Mexico – Taxes on Soft Drinks</i>
<i>Working Procedures</i>	<i>Working Procedures for Appellate Review</i> , WT/AB/WP/5, 4 January 2005
WTO	World Trade Organization

WORLD TRADE ORGANIZATION  
APPELLATE BODY

**Mexico – Tax Measures on Soft Drinks and Other Beverages**

Mexico, *Appellant*  
United States, *Appellee*

Canada, *Third Participant*  
China, *Third Participant*  
European Communities, *Third Participant*  
Guatemala, *Third Participant*  
Japan, *Third Participant*

AB-2005-10

Present:  
Taniguchi, Presiding Member  
Janow, Member  
Sacerdoti, Member

**I. Introduction**

1. Mexico appeals certain issues of law and legal interpretations developed in the Panel Report, *Mexico – Tax Measures on Soft Drinks and Other Beverages* (the "Panel Report").<sup>1</sup> The Panel was established to consider a complaint by the United States concerning certain tax measures and bookkeeping requirements imposed by Mexico on soft drinks and other beverages that use sweeteners other than cane sugar.

2. The measures challenged by the United States include: (i) a 20 per cent tax on the transfer or, as applicable, the importation of soft drinks and other beverages that use any sweetener other than cane sugar (the "soft drink tax"); (ii) a 20 per cent tax on specific services (commission, mediation, agency, representation, brokerage, consignment, and distribution), when such services are provided for the purpose of transferring products such as soft drinks and other beverages that use any sweetener other than cane sugar (the "distribution tax"); and (iii) a number of requirements imposed on taxpayers subject to the soft drink tax and to the distribution tax (the "bookkeeping requirements").<sup>2</sup> Before the Panel, the United States claimed that these measures are inconsistent with paragraphs 2 and 4 of Article III of the *General Agreement on Tariffs and Trade 1994* (the "GATT 1994").

3. In its first written submission to the Panel, Mexico requested that the Panel decide, as a preliminary matter, to "decline to exercise its jurisdiction in this case"<sup>3</sup> and that it "recommend to the

<sup>1</sup>WT/DS308/R, 7 October 2005.

<sup>2</sup>These measures are described in more detail in paragraphs 2.2-2.5 of the Panel Report.

<sup>3</sup>Panel Report, para. 4.2.

parties that they submit their respective grievances to an Arbitral Panel, under Chapter Twenty of the NAFTA<sup>4</sup>], which can address both Mexico's concern with respect to market access for Mexican cane sugar in the United States under the NAFTA and the United States' concern with respect to Mexico's tax measures.<sup>5</sup> Mexico also stated that, in the event the Panel decided to exercise jurisdiction, the Panel should find that the measures are justified pursuant to Article XX(d) of the GATT 1994.<sup>6</sup>

4. On 18 January 2005, the Panel issued a preliminary ruling in which it rejected Mexico's request.<sup>7</sup> In doing so, the Panel concluded that, "under the DSU<sup>8</sup>], it had no discretion to decide whether or not to exercise its jurisdiction in a case properly before it."<sup>9</sup> The Panel added that, "even if it had such discretion, the Panel did not consider that there were facts on record that would justify the Panel declining to exercise its jurisdiction in the present case."<sup>10</sup>

5. In its Report, circulated to Members of the World Trade Organization (the "WTO") on 7 October 2005, the Panel concluded that:

- (a) With respect to Mexico's soft drink tax and distribution tax:
- (i) As imposed on sweeteners, imported beet sugar is subject to internal taxes in excess of those applied to like domestic sweeteners, in a manner inconsistent with Article III:2, first sentence, of the GATT 1994;
  - (ii) As imposed on sweeteners, imported HFCS<sup>11</sup> is being taxed dissimilarly compared with the directly competitive or substitutable products, so as to afford protection to the Mexican domestic production of cane sugar, in a manner inconsistent with Article III:2, second sentence, of the GATT 1994;
  - (iii) As imposed on sweeteners, imported beet sugar and HFCS are accorded less favourable treatment than that accorded to like products of national origin, in a manner inconsistent with Article III:4 of the GATT 1994;
  - (iv) As imposed on soft drinks and syrups, imported soft drinks and syrups sweetened with non-cane sugar sweeteners (including HFCS and beet sugar) are subject to internal taxes in excess of those applied to like domestic products, in a manner inconsistent with Article III:2, first sentence, of the GATT 1994.

<sup>4</sup>North American Free Trade Agreement (the "NAFTA").

<sup>5</sup>Panel Report, para. 3.2.

<sup>6</sup>*Ibid.*

<sup>7</sup>The Panel's preliminary ruling is reproduced as Annex B to the Panel Report.

<sup>8</sup>*Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU").

<sup>9</sup>Panel Report, para. 7.1.

<sup>10</sup>*Ibid.*

<sup>11</sup>High-fructose corn syrup ("HFCS").

- (b) With respect to Mexico's bookkeeping requirements: As imposed on sweeteners, imported beet sugar and HFCS are accorded less favourable treatment than that accorded to like products of national origin, in a manner inconsistent with Article III:4 of the GATT 1994.<sup>12</sup>

The Panel rejected Mexico's defence under Article XX(d) of the GATT 1994, concluding that "the challenged tax measures are not justified as measures that are necessary to secure compliance by the United States with laws or regulations which are not inconsistent with the provisions of the GATT 1994."<sup>13</sup> The Panel therefore recommended "that the Dispute Settlement Body request Mexico to bring the inconsistent measures ... into conformity with its obligations under the GATT 1994."<sup>14</sup>

6. On 6 December 2005, Mexico notified the Dispute Settlement Body (the "DSB") of its intention to appeal certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel, pursuant to Article 16.4 of the DSU, and filed a Notice of Appeal<sup>15</sup> pursuant to Rule 20(1) of the *Working Procedures for Appellate Review* (the "*Working Procedures*").<sup>16</sup> On 13 December 2005, Mexico filed an appellant's submission.<sup>17</sup> In its appeal, Mexico challenges the Panel's preliminary ruling rejecting Mexico's request that the Panel decline to exercise jurisdiction in this case, as well as the Panel's findings concerning Article XX(d) of the GATT 1994. Mexico did not appeal the Panel's findings under Article III of the GATT 1994. On 6 January 2006, the United States filed an appellee's submission.<sup>18</sup> On the same day, China, the European Communities, and Japan each filed a third participant's submission.<sup>19</sup> Also on the same day, Canada and Guatemala each notified the Appellate Body Secretariat of its intention to appear at the oral hearing as a third participant.<sup>20</sup>

7. By letter dated 5 January 2006, Mexico requested authorization to correct certain clerical errors in its appellant's submission pursuant to Rule 18(5) of the *Working Procedures*. On 9 January 2006, the Appellate Body Division hearing the appeal ("the Division") invited all participants and third participants to comment on Mexico's request, in accordance with Rule 18(5). On 11 January 2006, the United States responded that, although some of the requested corrections are

<sup>12</sup>Panel Report, para. 9.2. (original underlining)

<sup>13</sup>*Ibid.*, para. 9.3.

<sup>14</sup>*Ibid.*, para. 9.5.

<sup>15</sup>WT/DS308/10 (attached as Annex I to this Report).

<sup>16</sup>WT/AB/WP/5, 4 January 2005.

<sup>17</sup>Pursuant to Rule 21(1) of the *Working Procedures*. A courtesy English translation of Mexico's appellant's submission, prepared by Mexico, was provided to the participants and third participants on 16 December 2005.

<sup>18</sup>Pursuant to Rule 22(1) of the *Working Procedures*.

<sup>19</sup>Pursuant to Rule 24(1) of the *Working Procedures*.

<sup>20</sup>Pursuant to Rule 24(2) of the *Working Procedures*.

not "clearly clerical", within the meaning of Rule 18(5), "[i]n the circumstances of this dispute", the United States did not object to Mexico's request. No other comments were received. By letter dated 16 January 2006, the Division authorized Mexico to correct the clerical errors in its appellant's submission but emphasized, however, that it had not been requested, and did not make, a finding "as to whether all of the corrections requested by Mexico are 'clerical' within the meaning of Rule 18(5) of the *Working Procedures*."

8. On 13 January 2006, the Appellate Body received an *amicus curiae* brief from *Cámara Nacional de las Industrias Azucarera y Alcohólica* (National Chamber of the Sugar and Alcohol Industries) of Mexico.<sup>21</sup> The Division did not find it necessary to take the brief into account in resolving the issues raised in this appeal.

9. The oral hearing in this appeal was held on 18 January 2006. The participants and third participants presented oral arguments (with the exception of Guatemala) and responded to questions posed by the Members of the Division hearing the appeal.

## II. Arguments of the Participants and the Third Participants

### A. *Claims of Error by Mexico – Appellant*

#### 1. Exercise of Jurisdiction

10. Mexico argues that the Panel erred in rejecting Mexico's request that it decline to exercise jurisdiction in the circumstances of the present dispute. According to Mexico, the Panel's decision was primarily based on the Panel's view that Article 11 of the DSU "compels a WTO [p]anel to address the claims" on which a finding is necessary to enable the DSB to make sufficiently precise recommendations or rulings to the parties to the dispute and that, therefore, a WTO panel has no discretion to decline to exercise validly established jurisdiction.<sup>22</sup> Mexico submits that this is incorrect and ignores the fact that, like other international bodies and tribunals, WTO panels have certain "implied jurisdictional powers"<sup>23</sup> that derive from their nature as adjudicative bodies. According to Mexico, such powers include the power to refrain from exercising substantive

<sup>21</sup>At the oral hearing, Mexico stated that its arguments are set out in its appellant's and oral submissions. Mexico added, however, that it would not object should the Appellate Body decide to accept the *amicus* brief. The United States noted that the *amicus* brief had been received late in the proceedings and that it presented new arguments and claims of error that were not part of Mexico's Notice of Appeal. Accordingly, while taking the view that the Appellate Body had the authority to accept the brief, the United States argued that it should decline to do so in the circumstances of this dispute.

<sup>22</sup>Mexico's appellant's submission, para. 64 ("*obliga a un Grupo Especial de la OMC a abordar las reclamaciones*").

<sup>23</sup>*Ibid.*, para. 65 ("*facultades implícitas en relación con su competencia*").

jurisdiction in circumstances where "the underlying or predominant elements of a dispute derive from rules of international law"<sup>24</sup> under which claims cannot be judicially enforced in the WTO, such as the NAFTA provisions or when one of the disputing parties refuses to take the matter to the "appropriate forum".<sup>25</sup> Mexico contends, in this regard, that the United States' claims under Article III of the GATT 1994 are inextricably linked to a broader dispute<sup>26</sup> concerning the conditions provided under the NAFTA for access of Mexican sugar to the United States market, and that only a NAFTA panel could resolve the dispute between the parties.

11. Mexico further emphasizes that there is nothing in the DSU that explicitly rules out the existence of a WTO panel's power to decline to exercise its jurisdiction even in a case that is properly brought before it. Mexico adds that the application by panels of the principle of "judicial economy" illustrates that notwithstanding the requirement of Article 7.2 of the DSU that panels address the relevant provisions in any covered agreement or agreements cited by the parties to the dispute, WTO panels can decide not to address certain claims. Thus, according to Mexico, there is no question that WTO panels have an implicit or inherent competence. As other examples of panels' "implied jurisdictional powers", Mexico points, *inter alia*, to the power of panels to determine whether they have substantive jurisdiction over a matter and the power to decide all matters that are inherent to the "adjudicative function"<sup>27</sup> of panels.

12. Finally, referring to the ruling of the Permanent Court of International Justice (the "PCIJ") in the *Factory at Chorzów* case, Mexico calls into question the "applicability" of its WTO obligations towards the United States in the context of this dispute.<sup>28</sup>

#### 2. Article XX(d) of the GATT 1994

13. Mexico appeals the Panel's finding that the measures at issue are not justified pursuant to Article XX(d) of the GATT 1994. In addition, Mexico requests the Appellate Body to complete the analysis and find that its tax measures are justified under Article XX(d) of the GATT 1994, because

<sup>24</sup>Mexico's appellant's submission, para. 73 ("*los elementos predominantes de una disputa derivan de reglas del derecho internacional*").

<sup>25</sup>*Ibid.* ("*foro adecuado*").

<sup>26</sup>*Ibid.*

<sup>27</sup>*Ibid.*, para. 67 ("*función jurisdiccional*").

<sup>28</sup>See *ibid.*, paras. 73-74. The passage of the ruling that Mexico refers to reads as follows:

... one party cannot avail himself of the fact that the other has not fulfilled some obligation ... if the former party has ... prevented the latter ... from having recourse to the tribunal which would have been open to him.

(Permanent Court of International Justice, *Factory at Chorzów* (*Germany v. Poland*) (Jurisdiction), 1927, PCIJ Series A, No. 9, p. 31) (underlining added by Mexico omitted)

the measures are necessary "to secure compliance" by the United States of its obligations under the NAFTA.

14. Mexico asserts that the Panel erred in finding that the measures at issue are not designed "to secure compliance" within the meaning of Article XX(d). According to Mexico, this finding is based on an erroneous interpretation of the terms "to secure compliance" as involving enforcement action within a *domestic* legal system. Mexico argues that there is no basis to exclude action taken to enforce *international* treaty obligations from the scope of Article XX(d). Mexico adds that, in the broader context of international law, countermeasures are measures aimed at securing compliance with international obligations. Mexico further submits that the Panel erred by equating the concept of "enforcement" with that of "coercion". In Mexico's view, the Panel's effort to distinguish between actions at the domestic level and at the international level based on its understanding of the concept of coercion in this dispute has no textual basis, because Article XX(d) simply does not refer to the use of coercion.

15. Moreover, Mexico asserts that the Panel erred by confusing the issue of the "design" of the measure under Article XX(d) with the issue of its "outcome".<sup>29</sup> Rather than examining whether Mexico's measures were put in place in order to secure the United States' compliance with its NAFTA obligations, the Panel considered the effectiveness of those measures. Mexico emphasizes that "even if the outcome of a measure is completely uncertain or unpredictable, the measure in question can, nevertheless be 'designed to secure compliance with laws and regulations' within the meaning of Article XX(d)".<sup>30</sup> Contrary to the Panel's finding, the issue of the likely outcome of a given measure is not legally relevant to the assessment of the design of the measure under Article XX(d). Thus, Mexico takes issue with the Panel's finding that the "uncertain outcome of international countermeasures is a reason for disqualifying them as measures eligible for consideration under Article XX(d)".<sup>31</sup> Mexico notes, in this regard, that nothing in the text of Article XX(d) suggests that any measure is *a priori* ineligible as a measure "to secure compliance with laws and regulations" on the basis of its "uncertain outcome".

16. Turning to the meaning of the terms "laws and regulations" in Article XX(d), Mexico notes that the Panel's interpretation of these terms is based on the erroneous conclusions reached by the Panel with respect to the terms "to secure compliance". Mexico submits that the words "laws" and

<sup>29</sup>Mexico's appellant's submission, para. 98 ("destino", "resultado").

<sup>30</sup>*Ibid.*, para. 102 ("aun si el resultado de la medida es totalmente incierto, impredecible, bien puede estar destinada a lograr la observancia de las leyes y reglamentos" en el sentido del artículo XX(d)).

<sup>31</sup>*Ibid.*, para. 104 ("el resultado incierto de las contramedidas internacionales es una razón para excluirlas como medidas que pueden ser objeto de consideración, en el marco del inciso (d) del artículo XX") (quoting Panel Report, para. 8.187).

"regulations" are expressly qualified in other provisions of the covered agreements; the absence of qualifying language in Article XX(d) thus supports the view that the terms are not limited to *domestic* laws or regulations, but include international agreements. Mexico adds that a review of the Article XX exceptions reveals that only three—(paragraphs (c), (e), and (i))—are, expressly or by implication, concerned with an activity that would occur *within* the territory of the Member seeking to justify its measures. This position, according to Mexico, is supported by the Appellate Body's findings in *US – Shrimp (Article 21.5 – Malaysia)*.<sup>32</sup>

17. Mexico further requests, in the event the Appellate Body should reverse the Panel's conclusion, that it complete the Panel's analysis and find that the Mexican measures are "necessary" within the meaning of Article XX(d) and meet the requirements of the chapeau of that Article. According to Mexico, the uncontested facts and evidence in the Panel record, and the Panel's acknowledgement that Mexico's measures have "attracted the attention" of the United States, provide an ample basis on which to complete the analysis and conclude that the measures are "necessary" within the meaning of Article XX(d).

18. Mexico observes that, before the Panel, the United States could not identify any alternative measure that Mexico could and should have used in order to attain its legitimate objective. It further explains that the fact that a measure does not or has not yet achieved its objective does not mean that it is not "necessary" within the meaning of Article XX(d). It may mean that it is insufficient to secure compliance, or that it is insufficient to secure immediate compliance, but can do so over time; however, it says nothing about whether the measure is "necessary". Moreover, Mexico submits that the evidence on the record demonstrates that the measures at issue have contributed to securing compliance in the circumstances of this case by changing the dynamics of the NAFTA dispute and forcing the United States to pay attention to Mexico's grievances, and also contradicts the Panel's finding that Mexico's measures do not contribute to securing compliance in this dispute.

19. As regards the chapeau of Article XX of the GATT 1994, Mexico asserts that its measures neither arbitrarily nor unjustifiably discriminate between countries where the same conditions prevail. Rather than constituting "arbitrary or unjustifiable discrimination", the measures constitute "limited

<sup>32</sup>Mexico's appellant's submission, paras. 174 and 177-178 (referring to Appellate Body Report, *US – Shrimp (Article 21.5 – Malaysia)*, paras. 123-124 and 128-130).

sectoral retaliation in the relevant market segment (*i.e.*, the sweeteners market).<sup>33</sup> Nor can the measures be said to be a "disguised restriction on [international] trade" because they constitute "a proportionate, legitimate and legally justified response to actions and omissions of the United States"<sup>34</sup>, and, furthermore, the measures have been published.

20. Finally, Mexico argues that the Panel, "separately and in addition"<sup>35</sup> to the previous errors, failed to make "an objective assessment of the facts", as required by Article 11 of the DSU, in finding that "Mexico has not established that its measures contribute to securing compliance in the circumstances of this case."<sup>36</sup> According to Mexico, the Panel's finding is based solely on the Panel's view that attracting the attention of the United States is not equivalent to securing compliance with a law or regulation and ignores that "achieving the objectives sought by the countermeasures can take time".<sup>37</sup>

#### B. *Arguments of the United States – Appellee*

##### 1. Exercise of Jurisdiction

21. The United States submits that the Panel properly rejected Mexico's request for the Panel to refrain from exercising jurisdiction in the present dispute.

22. Referring to Article 11 of the DSU, the United States observes that, if the Panel had declined to exercise jurisdiction over this dispute, or had agreed to Mexico's request that it refrain from issuing findings and recommendations, the Panel would have made no findings on the United States' claims that Mexico's tax measures are inconsistent with Article III of the GATT 1994. This would have left the DSB "unable to give any rulings or (as is appropriate in this dispute) to make any

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<sup>33</sup>Mexico's appellant's submission, para. 173 ("*retorsiones sectoriales limitadas al segmento del mercado relevante (i.e., el mercado de los edulcorantes)*"). Mexico asserts that the facts of this case are similar to the situation examined by the Appellate Body in *US – Shrimp (Article 21.5 – Malaysia)*. Mexico explains that, in that dispute, the Appellate Body found that a United States unilateral measure was not inconsistent with the chapeau of Article XX of the GATT 1994. According to Mexico, in that case, the Appellate Body did not require the United States to conclude an international agreement with the disputing parties, but rather required it to have made good faith efforts in that direction. In this case, Mexico argues that it has sought to resolve the dispute through NAFTA and bilateral negotiations, but "the United States has essentially blocked Mexico's ability to have its grievance resolved" (Mexico's appellant's submission, paras. 174-181 ("*Estados Unidos esencialmente ha bloqueado la posibilidad de México para resolver su agravio.*"))

<sup>34</sup>*Ibid.*, para. 182 ("*una respuesta proporcional, legítima y legalmente justificada a las acciones y omisiones de Estados Unidos*").

<sup>35</sup>*Ibid.*, heading III.E ("*independiente y adicional*").

<sup>36</sup>Panel Report, para. 8.186. See also, Mexico's Notice of Appeal, para. 3.

<sup>37</sup>Mexico's appellant's submission, para. 166 ("*la consecución de los objetivos de las contramedidas puede llevar tiempo*").

recommendations"<sup>38</sup> in accordance with the rights and obligations under the DSU and the GATT 1994. The United States emphasizes that such a result is incompatible with the text of the DSU and would have required the Panel to disregard the mandate given to it by the DSB. Moreover, the United States observes that the Panel's own terms of reference in this dispute instructed the Panel to examine the matter referred to the DSB by the United States and to make such findings as will assist the DSB in making the recommendations and rulings provided for under the DSU.

23. Referring to Articles 3.2 and 19.2 of the DSU, the United States adds that, if a panel were to decline to exercise jurisdiction over a particular dispute, it would diminish the rights of the complaining Member under the DSU and other covered agreements. The United States further notes that prior reports of panels and the Appellate Body also support the Panel's findings. In this regard, the United States refers to *Mexico – Corn Syrup (Article 21.5 – US)*, where the Appellate Body stated that "panels are required to address issues that are put before them by the parties to a dispute."<sup>39</sup>

24. The United States observes that Mexico has referred to the principle of judicial economy as an example of "situations where WTO panels have refrained from exercising validly established substantive jurisdiction on certain claims that are before them."<sup>40</sup> However, the United States submits that, "when a panel exercises judicial economy, it does not decline to exercise substantive jurisdiction either over a dispute or certain claims in a dispute. Rather, the panel ... declines to make findings on certain claims when resolution of such claims is not necessary for the panel to fulfill its mandate under Article 11 of the DSU and its terms of reference."<sup>41</sup> In other words, judicial economy "does not relieve a panel from its duty to carry out its mandate under Articles 7 and 11 of the DSU to resolve the dispute"<sup>42</sup> before it.

##### 2. Article XX(d) of the GATT 1994

25. The United States submits that the Panel properly found that Mexico's tax measures are not designed "to secure compliance" and, thus, are not justified as measures "to secure compliance with laws or regulations" within the meaning of Article XX(d) of the GATT 1994. It notes that previous GATT and WTO disputes in which Article XX(d) has been invoked have involved domestic laws or regulations.

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<sup>38</sup>United States' appellee's submission, para. 124.

<sup>39</sup>*Ibid.*, para. 127 (quoting Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 36).

<sup>40</sup>*Ibid.*, para. 129 (quoting Mexico's appellant's submission, para. 68).

<sup>41</sup>*Ibid.* (referring to Appellate Body Report, *US – Wool Shirts and Blouses*, p. 19, DSR 1997:1, 323, at 340; and to Appellate Body Report, *Canada – Wheat Exports and Grain Imports*, para. 133).

<sup>42</sup>*Ibid.*, para. 130.

26. The United States agrees with the Panel's analysis of the terms "laws or regulations" and, therefore, supports the Panel's finding that these terms refer only to *domestic* laws or regulations and not to obligations under international agreements. The United States explains that Article XX(d) refers to "laws" and "regulations" in the plural, while the singular "law" is used when referring to "international law".<sup>43</sup> The United States further observes that the terms "laws or regulations" precede the words "which are not inconsistent" in Article XX(d) and explains that the term "inconsistent" appears elsewhere in the GATT 1994 in connection with domestic measures. In contrast, the WTO agreements use the word "conflict" when referring to international obligations.

27. The United States further submits that Mexico's interpretation of the terms "laws or regulations" would undermine Articles 22 and 23 of the DSU, as it would permit action, including the suspension of concessions, by any Member "outside the rules of the DSU".<sup>44</sup> The United States observes that Article XX(d) was not intended to provide the basis for suspending concessions under the WTO agreements upon a mere allegation of a breach of a non-WTO international agreement. Otherwise, according to the United States, "this would effectively convert WTO dispute settlement into a forum of general dispute resolution for all international agreements."<sup>45</sup> Furthermore, the United States argues that, if the terms "laws or regulations" are read to include obligations under non-WTO agreements, the WTO dispute settlement system "would become a forum for WTO Members to allege and obtain findings as to the consistency of another Member's measure with any non-WTO agreement."<sup>46</sup> The United States, therefore, disagrees with Mexico's arguments that the phrase "laws or regulations" in Article XX(d) refers to international agreements.

28. With respect to the Panel's interpretation of the phrase "to secure compliance", the United States notes that the references to coercion were intended "merely [to] reinforce the Panel's view that 'enforcement' does not refer to the international level"<sup>47</sup> and not, as Mexico argues, to create an additional requirement for justifying a measure under Article XX(d). The United States therefore agrees with the Panel that the terms "to secure compliance" do not apply to measures taken by one Member to induce another Member to comply with obligations under a non-WTO treaty.

29. The United States also rejects Mexico's submission that the "Panel wrongly found that measures with an 'uncertain outcome' are *a priori* ineligible" as measures to secure compliance with

<sup>43</sup>The United States observes that Article 3.2 of the DSU and Article 17.6 of the *Anti-Dumping Agreement* also use the term "law" in the singular when referring to "public international law".

<sup>44</sup>United States' appellee's submission, para. 37.

<sup>45</sup>*Ibid.*, para. 85. (footnote omitted)

<sup>46</sup>*Ibid.*, para. 41.

<sup>47</sup>*Ibid.*, para. 54 (referring to Panel Report, paras. 8.175 and 8.178).

laws or regulations."<sup>48</sup> While the United States concedes that the Panel's analysis "could have admittedly been clearer"<sup>49</sup>, it also notes that the Panel did not require certainty, and argues that the Panel's remarks on this point simply characterized Mexico's failure to "put forth *any* evidence that its tax measures were designed to [secure] compliance."<sup>50</sup> The United States agrees with Mexico that "Article XX(d) does not require the party invoking the defense to establish that its measure will, without a doubt or with certainty, secure compliance with laws or regulations."<sup>51</sup> Nevertheless, the United States submits that Mexico has to provide some evidence that the measure is "designed" to secure such compliance.

30. For all these reasons, the United States submits that the Appellate Body should uphold the Panel's conclusion that Mexico's tax measures are *not* designed to secure compliance and, thus, are *not* justified as measures "to secure compliance with laws or regulations" within the meaning of Article XX(d) of the GATT 1994.

31. In the event the Appellate Body should reverse the Panel's finding and accept Mexico's request to complete the analysis, the United States asserts that Mexico's measures are neither "necessary" for purposes of Article XX(d), nor do they meet the requirements of the chapeau of that Article. According to the United States, Mexico has not demonstrated that the measures at issue contribute to compliance by the United States with its NAFTA obligations and "ignores"<sup>52</sup> the fact that the trade impact of a measure is one of the factors that must be weighed and balanced when determining whether a measure is "necessary". The impact of Mexico's measures was "essentially [to] prohibit the use of imported HFCS in Mexican soft drinks and other beverages and to reduce import volumes".<sup>53</sup> The United States adds that "[i]t is difficult to understand how discriminating against imports from potentially every WTO Member is 'necessary' to secure [the United States'] compliance with [its] obligations under the NAFTA."<sup>54</sup> The United States further observes that the absence of alternative measures that could be reasonably available does not, in itself, mean that the challenged measures are "necessary". In any event, the United States submits that if Mexico's objective was to attract the attention of the United States, it could have pursued a variety of other actions, including pursuing the diplomatic avenues available under the NAFTA.

<sup>48</sup>United States' appellee's submission, para. 70 (quoting Mexico's appellant's submission, paras. 104-105).

<sup>49</sup>*Ibid.*, para. 71.

<sup>50</sup>*Ibid.* (original emphasis)

<sup>51</sup>*Ibid.*, para. 72. (footnote omitted)

<sup>52</sup>*Ibid.*, para. 96.

<sup>53</sup>*Ibid.*, para. 97.

<sup>54</sup>*Ibid.*

32. The United States submits, furthermore, that Mexico's measures do not meet the requirements of the chapeau of Article XX of the GATT 1994. The only evidence that Mexico offers to support its contention that the measures do not constitute arbitrary or unjustifiable discrimination is the characterization of the measures as international countermeasures.<sup>55</sup> This is insufficient, argues the United States, for Mexico to meet its burden of proof. Moreover, the fact that Mexico may have been transparent about its measures is not sufficient to establish that such measures are not a "disguised restriction on trade".<sup>56</sup>

33. Lastly, the United States requests the Appellate Body to reject Mexico's contention that the Panel did not make an objective assessment of the facts, as required by Article 11 of the DSU. According to the United States, the Panel did not "ignore" arguments or evidence submitted by Mexico. The United States further explains that, in any event, the errors alleged by Mexico in support of its claim under Article 11 of the DSU "relate to the interpretation of Article XX, and do not support a conclusion that the Panel breached Article 11."<sup>57</sup>

#### C. *Arguments of the Third Participants*

##### 1. China

34. Referring to Articles 7 and 11 of the DSU, China argues that a WTO panel does not have an implied power to refrain from performing its "statutory function".<sup>58</sup> China submits that, if a panel that is "empowered and obligated"<sup>59</sup> to assist the DSB in the settlement of a dispute declines to exercise jurisdiction, such a decision would create legal uncertainty and be contrary to the aim of providing security and predictability to the multilateral trading system as well as the prompt settlement of disputes as provided for in Article 3.3 of the DSU. China argues, moreover, that the notion of judicial economy is "relevant and applicable"<sup>60</sup> only if a panel has assumed the jurisdiction defined by its

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<sup>55</sup> According to the United States, the Appellate Body rulings in *US – Shrimp (Articles 21.5 – Malaysia)* do not support Mexico's position, because that dispute did not involve a disagreement about the commitments made under an international agreement. (United States' appellee's submission, paras. 109-110)

<sup>56</sup> *Ibid.*, para. 114.

<sup>57</sup> *Ibid.*, para. 118.

<sup>58</sup> China's third participant's submission, para. 5.

<sup>59</sup> *Ibid.*, para. 6.

<sup>60</sup> *Ibid.*, para. 7.

terms of reference and has made "such findings as will assist the DSB" within the meaning of Article 11 of the DSU.

35. China asserts that the terms "laws or regulations" in Article XX(d) do not encompass international agreements. China states that Article X of the GATT 1994 provides contextual guidance for the interpretation of Article XX(d). Article X expressly distinguishes between "[l]aws, regulations, judicial decisions and administrative rulings" and "[a]greements ... between the government or a governmental agency of any Member and the government or governmental agency of any other Member". China adds that interpreting "laws or regulations" to include international agreements would allow a WTO Member to justify under Article XX(d) its deviation from its WTO obligations in the name of any remedial measure in response to any alleged breach of any non-WTO international agreement. Such a scenario, according to China, is not consistent with the object and purpose of the GATT 1994.

##### 2. European Communities

36. The European Communities submits that the Appellate Body should uphold the Panels' finding that it did not have the discretion to decline to exercise jurisdiction in this case. The European Communities submits that "the functions and obligations of WTO Panels must be established on the basis of the DSU, and particularly Article 11 thereof."<sup>61</sup> On this basis, the European Communities agrees that a panel has an inherent power to establish whether it has jurisdiction, and whether a particular matter is within its jurisdiction. However, the European Communities argues that a panel may not freely, or by "the notion of 'judicial economy'", decide to refrain from exercising its jurisdiction "in a case properly brought before it under the DSU."<sup>62</sup>

37. The European Communities asserts, furthermore, that the Appellate Body should uphold the Panel's finding that only measures made applicable in the domestic legal order of a WTO Member constitute "laws or regulations" within the meaning of Article XX(d). The European Communities disagrees, however, with the Panel's finding that "international agreements, even when incorporated into the domestic law of a WTO Member, can never be regarded as 'laws or regulations' for the purposes of Article XX(d)".<sup>63</sup> In addition, the European Communities takes issue with the Panel's interpretation of the terms "to secure compliance" as requiring a degree of certainty in the results that may be achieved through the measure.

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<sup>61</sup> European Communities' third participant's submission, para. 8.

<sup>62</sup> *Ibid.*, paras. 10-11.

<sup>63</sup> *Ibid.*, para. 44.

3. Japan

38. Japan disagrees with the Panel's interpretation of the terms "to secure compliance" in Article XX(d). In this regard, Japan submits that Article XX(d) does not necessarily exclude measures that have, as a purpose, to secure compliance, but are not accompanied by compulsory enforcement. According to Japan, compliance can be secured by a request or a command without being accompanied by any coercion. Japan considers that the Panel erred by indicating that the determination of whether a measure is designed "to secure compliance" should be analyzed based on the degree of certainty of its outcome. Nevertheless, Japan agrees with the Panel's finding that Article XX(d) does not cover international agreements. Japan explains that the terms "laws or regulations", read together with the phrase "to secure compliance", "presuppose a hierarchical structure that is associated with the relation between the state and its subjects"<sup>64</sup> and, therefore, excludes international agreements.

**III. Issues Raised in This Appeal**

39. The following issues are raised in this appeal:

- (a) whether the Panel erred in concluding that a WTO panel "has no discretion to decide whether or not to exercise its jurisdiction in a case properly before it"<sup>65</sup> and, if so, whether the Panel erred in declining to exercise that discretion in the circumstances of this dispute;
- (b) whether the Panel erred in concluding that Mexico's measures do not constitute measures "to secure compliance with laws or regulations", within the meaning of Article XX(d) of the GATT 1994<sup>66</sup>, and
- (c) whether the Panel failed to make an objective assessment of the facts of the case, as required by Article 11 of the DSU, in concluding that "even if the assumption were to be made in the abstract that international countermeasures are potentially capable of qualifying as measures designed to secure compliance", within the meaning of Article XX(d) of the GATT 1994, "Mexico has not established that its measures contribute to securing compliance in the circumstances of this case."<sup>67</sup>

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<sup>64</sup> Japan's third participant's submission, para. 22.

<sup>65</sup> Panel Report, para. 7.18.

<sup>66</sup> *Ibid.*, para. 8.198.

<sup>67</sup> *Ibid.*, para. 8.186.

**IV. The Panel's Exercise of Jurisdiction**

A. *Introduction*

40. In its first written submission to the Panel, Mexico requested that the Panel decide, as a preliminary matter, to decline to exercise jurisdiction "in favour of an Arbitral Panel under Chapter Twenty of the North American Free Trade Agreement (NAFTA)."<sup>68</sup> In a preliminary ruling, the Panel rejected Mexico's request and found instead that, "under the DSU, it had no discretion to decide whether or not to exercise its jurisdiction in a case properly before it."<sup>69</sup> The Panel added that even if it had such discretion, it "did not consider that there were facts on record that would justify the Panel declining to exercise its jurisdiction in the present case."<sup>70</sup>

41. In its reasoning, the Panel opined that "discretion may be said to exist only if a legal body has the freedom to choose among several options, all of them equally permissible in law."<sup>71</sup> According to the Panel, "such freedom ... would exist within the framework of the DSU only if a complainant did not have a legal right to have a panel decide a case properly before it."<sup>72</sup> Referring to Article 11 of the DSU and to the ruling of the Appellate Body in *Australia – Salmon*, the Panel observed that "the aim of the WTO dispute settlement system is to resolve the matter at issue in particular cases and to secure a positive solution to disputes" and that a panel is required "to address the claims on which a finding is necessary to enable the DSB to make sufficiently precise recommendations or rulings to the parties."<sup>73</sup> From this, the Panel concluded that a WTO panel "would seem therefore not to be in a position to choose freely whether or not to exercise its jurisdiction."<sup>74</sup> Referring to Articles 3.2 and 19.2 of the DSU, the Panel further stated that "[i]f a WTO panel were to decide not to exercise its jurisdiction in a particular case, it would diminish the rights of the complaining Member under the DSU and other WTO covered agreements."<sup>75</sup> The Panel added that Article 23 of the DSU "make[s] it clear that a WTO Member that considers that any of its WTO benefits have been nullified or impaired as a result of a measure adopted by another Member has the right to bring the case before the WTO dispute settlement system."<sup>76</sup>

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<sup>68</sup> Panel Report, para. 7.1.

<sup>69</sup> *Ibid.*

<sup>70</sup> *Ibid.*

<sup>71</sup> *Ibid.*, para. 7.7.

<sup>72</sup> *Ibid.*

<sup>73</sup> *Ibid.*, para. 7.8 (referring to Appellate Body Report, *Australia – Salmon*, para. 223).

<sup>74</sup> *Ibid.*

<sup>75</sup> *Ibid.*, para. 7.9.

<sup>76</sup> *Ibid.*

42. On appeal, Mexico contends that the Panel erred in rejecting Mexico's request that it decline to exercise jurisdiction in the circumstances of the present dispute. Mexico submits that WTO panels, like other international bodies and tribunals, "have certain implied jurisdictional powers that derive from their nature as adjudicative bodies."<sup>77</sup> Such powers include the power to refrain from exercising substantive jurisdiction in circumstances where "the underlying or predominant elements of a dispute derive from rules of international law under which claims cannot be judicially enforced in the WTO, such as the NAFTA provisions" or "when one of the disputing parties refuses to take the matter to the appropriate forum."<sup>78</sup> Mexico argues, in this regard, that the United States' claims under Article III of the GATT 1994 are inextricably linked to a broader dispute<sup>79</sup> regarding access of Mexican sugar to the United States' market under the NAFTA. Mexico further emphasizes that "[t]here is nothing in the DSU ... that explicitly rules out the existence of"<sup>80</sup> a WTO panel's power to decline to exercise validly established jurisdiction and submits that "the Panel should have exercised this power in the circumstances of this dispute."<sup>81</sup>

43. In contrast, the United States argues that, "[t]he Panel's own terms of reference in this dispute instructed the Panel 'to examine ... the matter referred to the DSB by the United States'"<sup>82</sup> and "to make such findings as will assist the DSB" in making the recommendations and rulings provided for under the DSU. China and the European Communities agree with the United States that the Panel had no discretion to decline to exercise jurisdiction. China submits that if a panel declines to exercise jurisdiction over a dispute, such a decision will create legal uncertainty, contrary to the aim of providing security and predictability to the multilateral trading system and the prompt settlement of disputes as provided for in Article 3.3 of the DSU.<sup>83</sup> The European Communities agrees with the Panel's finding that it did not have discretion to decline to exercise jurisdiction in this case, and emphasizes that "the functions and obligations of WTO Panels must be established on the basis of the DSU, and particularly Article 11 thereof."<sup>84</sup>

<sup>77</sup>Mexico's appellant's submission, para. 65 ("*tienen ciertas facultades implícitas en relación con su competencia, las cuales derivan de su propia naturaleza como órganos jurisdiccionales*").

<sup>78</sup>*Ibid.*, para. 73 ("*los elementos predominantes de una disputa derivan de reglas del derecho internacional, cuyo cumplimiento no puede reclamarse en el marco OMC, por ejemplo las disposiciones del TLCAN*", "*cuando una de las partes contendientes se rehúsa a someterse al foro adecuado*").

<sup>79</sup>*Ibid.*

<sup>80</sup>*Ibid.*, para. 65 ("*Nada en el ESD ... explícitamente descarta que ... existan*").

<sup>81</sup>*Ibid.*, para. 72 ("*el Grupo Especial debió haber ejercido esa facultad en las circunstancias de esta disputa*").

<sup>82</sup>United States' appellee's submission, para. 125.

<sup>83</sup>China's third participant's submission, para. 6.

<sup>84</sup>European Communities' third participant's submission, para. 8.

## B. Analysis

44. Before addressing Mexico's arguments, we note that "Mexico does not question that the Panel has jurisdiction to hear the United States' claims."<sup>85</sup> Moreover, Mexico does not claim "that there are legal obligations under the NAFTA or any other international agreement to which Mexico and the United States are both parties, which might raise legal impediments to the Panel hearing this case."<sup>86</sup> Instead, Mexico's position is that, although the Panel had the authority to rule on the merits of the United States' claims, it also had the "implied power" to abstain from ruling on them<sup>87</sup>, and "should have exercised this power in the circumstances of this dispute."<sup>88</sup> Hence, the issue before us in this appeal is not whether the Panel was legally precluded from ruling on the United States' claims that were before it, but, rather, whether the Panel could decline, and should have declined, to exercise jurisdiction with respect to the United States' claims under Article III of the GATT 1994 that were before it.

45. Turning to Mexico's arguments on appeal, we note, first, Mexico's argument that WTO panels, like other international bodies and tribunals, "have certain implied jurisdictional powers that derive from their nature as adjudicative bodies"<sup>89</sup>, and thus have a basis for declining to exercise jurisdiction. We agree with Mexico that WTO panels have certain powers that are inherent in their jurisdiction. Mexico's appellant's submission, para. 71 ("*México no discute que el Grupo Especial tiene competencia para resolver la reclamación que Estados Unidos ha interpuesto*") (quoting Mexico's response to questioning at the oral hearing).

<sup>86</sup>Panel Report, para. 7.13. In response to questioning at the oral hearing, Mexico argued that the panel in *Argentina – Poultry Anti-Dumping Duties* "at least contemplated the existence of a situation where an impediment found in another agreement might give rise to declining jurisdiction". The panel in *Argentina – Poultry Anti-Dumping Duties* referred to Article 1 of the Protocol of Olivos, which provides that, once a party decides to bring a case under either the MERCOSUR or WTO dispute settlement forum, that party may not bring a subsequent case regarding the same subject-matter in the other forum, and went on to state:

The Protocol of Olivos ... does not change our assessment, since that Protocol has not yet entered into force, and in any event it does not apply in respect of disputes already decided in accordance with the MERCOSUR Protocol of Brasilia. Indeed, the fact that parties to MERCOSUR saw the need to introduce the Protocol of Olivos suggests to us that they recognised that (in the absence of such Protocol) a MERCOSUR dispute settlement proceeding could be followed by a WTO dispute settlement proceeding in respect of the same measure.

(Panel Report, *Argentina – Poultry Anti-Dumping Duties*, para. 7.38) (footnote omitted)

<sup>87</sup>Thus, Mexico suggested that, in the circumstances of this dispute, it would not have been "appropriate" for the Panel "to issue findings on the merits of the United States' claims." (Panel Report, para. 7.11 (referring to Mexico's first written submission to the Panel, paras. 102-103))

<sup>88</sup>Mexico's appellant's submission, para. 72 ("*debió haber ejercido esa facultad en las circunstancias de esta disputa*").

<sup>89</sup>*Ibid.*, para. 65 ("*tienen ciertas facultades implícitas en relación con su competencia, las cuales derivan de su propia naturaleza como órganos jurisdiccionales*").

adjudicative function. Notably, panels have the right to determine whether they have jurisdiction in a given case, as well as to determine the scope of their jurisdiction. In this regard, the Appellate Body has previously stated that "it is a widely accepted rule that an international tribunal is entitled to consider the issue of its own jurisdiction on its own initiative, and to satisfy itself that it has jurisdiction in any case that comes before it."<sup>90</sup> Further, the Appellate Body has also explained that panels have "a margin of discretion to deal, always in accordance with due process, with specific situations that may arise in a particular case and that are not explicitly regulated."<sup>91</sup> For example, panels may exercise judicial economy, that is, refrain from ruling on certain claims, when such rulings are not necessary "to resolve the matter in issue in the dispute".<sup>92</sup> The Appellate Body has cautioned, nevertheless, that "[t]o provide only a partial resolution of the matter at issue would be false judicial economy."<sup>93</sup>

46. In our view, it does not necessarily follow, however, from the existence of these inherent adjudicative powers that, once jurisdiction has been validly established, WTO panels would have the authority to decline to rule on the entirety of the claims that are before them in a dispute. To the contrary, we note that, while recognizing WTO panels' inherent powers, the Appellate Body has previously emphasized that:

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<sup>90</sup> Appellate Body Report, *US – 1916 Act*, footnote 30 to para. 54. See also Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 53. In that dispute, the Appellate Body also stated that:

... panels have to address and dispose of certain issues of a fundamental nature, even if the parties to the dispute remain silent on those issues. ... [P]anels cannot simply ignore issues which go to the root of their jurisdiction—that is, to their authority to deal with and dispose of matters. Rather, panels must deal with such issues—if necessary, on their own motion—in order to satisfy themselves that they have authority to proceed.

(Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 36)

<sup>91</sup> Appellate Body Report, *EC – Hormones*, footnote 138 to para. 152. See also Appellate Body Report, *US – FSC (Article 21.5 – EC)*, paras. 247-248.

<sup>92</sup> Appellate Body Report, *US – Wool Shirts and Blouses*, p. 19, DSR 1997:1, 323, at 340. Mexico referred, in its appellant's submission, to a panel's discretion to apply judicial economy as "an example of situations where WTO panels have refrained from exercising validly established jurisdiction on certain claims that are before them." (Mexico's appellant's submission, para. 68 ("*un ejemplo de situaciones en las que grupos especiales de la OMC se han abstenido de resolver ciertas reclamaciones sobre las cuales tienen competencia sustantiva válidamente establecida*").) Mexico clarified at the oral hearing, however, that "it is clear that in the context of the exercise of judicial economy a panel cannot decline entirely to exercise jurisdiction." The United States noted, in this regard, that the doctrine of judicial economy "does not relieve a panel from its duty to carry out its mandate under Articles 7 and 11 of the DSU to resolve the dispute" before it. (United States' appellee's submission, para. 130)

<sup>93</sup> Appellate Body Report, *Australia – Salmon*, para. 223.

Although panels enjoy some discretion in establishing their own working procedures, *this discretion does not extend to modifying the substantive provisions of the DSU*. ... *Nothing in the DSU gives a panel the authority either to disregard or to modify ... explicit provisions of the DSU*.<sup>94</sup> (emphasis added)

47. With these considerations in mind, we examine the scope of a panel's jurisdictional power as defined, in particular, in Articles 3.2, 7.1, 7.2, 11, 19.2, and 23 of the DSU. Mexico argues that "[t]here is nothing in the DSU ... that explicitly rules out the existence of"<sup>95</sup> a WTO panel's power to decline to exercise its jurisdiction even in a case that is properly before it.

48. We first address Article 7 of the DSU, which governs the terms of reference of panels. Article 7 of the DSU states, in its first paragraph, that panels shall have the following terms of reference:

"To examine, in the light of the relevant provisions in (name of the covered agreement(s) cited by the parties to the dispute), the matter referred to the DSB by (name of party) in document ... and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in that/those agreement(s)."

The Panel in this dispute was established with standard terms of reference<sup>96</sup>, which instructed the Panel to "examine" the United States' claims that were before it and to "make findings" with respect to consistency of the measures at issue with Article III of the GATT 1994.

49. The second paragraph of Article 7 further stipulates that "[p]anels shall address the relevant provisions in any covered agreement or agreements cited by the parties to the dispute." The use of the words "shall address" in Article 7.2 indicates, in our view, that panels are required to address the relevant provisions in any covered agreement or agreements cited by the parties to the dispute.<sup>97</sup>

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<sup>94</sup> Appellate Body Report, *India – Patents (US)*, para. 92.

<sup>95</sup> Mexico's appellant's submission, para. 65 ("*Nada en el ESD ... explícitamente descarta que ... existan*").

<sup>96</sup> The Panel's terms of reference in this dispute were as follows:

To examine, in the light of the relevant provisions of the covered agreements cited by the United States in document WT/DS308/4, the matter referred to the DSB by the United States in that document, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements.

(WT/DS308/5/Rev.1, para. 2)

<sup>97</sup> In this regard, we further note the Appellate Body's statement that, "as a matter of due process, and the proper exercise of the judicial function, panels are required to address issues that are put before them by the parties to a dispute." (Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 36)

50. We turn next to Article 11 of the DSU, which provides that:

The function of panels is to assist the DSB in discharging its responsibilities under this Understanding and the covered agreements. Accordingly, a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements. . . .

51. Article 11 of the DSU states that panels *should* make an objective assessment of the matter before them. The Appellate Body has previously held that the word "should" can be used not only "to imply an exhortation, or to state a preference", but also "to express a duty [or] obligation".<sup>98</sup> The Appellate Body has repeatedly ruled that a panel would not fulfil its mandate if it were not to make an objective assessment of the matter.<sup>99</sup> Under Article 11 of the DSU, a panel is, therefore, charged with the *obligation* to "make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements." Article 11 also requires that a panel "make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements." It is difficult to see how a panel would fulfil that obligation if it declined to exercise validly established jurisdiction and abstained from making any finding on the matter before it.

52. Furthermore, Article 23 of the DSU states that Members of the WTO *shall* have recourse to the rules and procedures of the DSU when they "seek the redress of a violation of obligations ... under the covered agreements". As the Appellate Body has previously explained, "allowing measures to be the subject of dispute settlement proceedings ... is consistent with the comprehensive nature of the right of Members to resort to dispute settlement to 'preserve [their] rights and obligations ... under the covered agreements, and to clarify the existing provisions of those agreements'."<sup>100</sup> We also note in this regard that Article 3.3 of the DSU provides that the "prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is essential to the effective

<sup>98</sup>Appellate Body Report, *Canada – Aircraft*, para. 187 (quoting *The Concise Oxford English Dictionary* (Clarendon Press, 1995), p. 1283).

<sup>99</sup>See, for instance, Appellate Body Report, *EC – Export Subsidies on Sugar*, paras. 329 and 335. See also Appellate Body Report, *Canada – Aircraft*, paras. 187-188; and Appellate Body Report, *EC – Hormones*, para. 133.

<sup>100</sup>Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review*, para. 89. (footnote omitted)

functioning of the WTO".<sup>101</sup> The fact that a Member may initiate a WTO dispute whenever it considers that "any benefits accruing to [that Member] are being impaired by measures taken by another Member" implies that that Member is *entitled* to a ruling by a WTO panel.

53. A decision by a panel to decline to exercise validly established jurisdiction would seem to "diminish" the right of a complaining Member to "seek the redress of a violation of obligations" within the meaning of Article 23 of the DSU, and to bring a dispute pursuant to Article 3.3 of the DSU. This would not be consistent with a panel's obligations under Articles 3.2 and 19.2 of the DSU.<sup>102</sup> We see no reason, therefore, to disagree with the Panel's statement that a WTO panel "would seem ... not to be in a position to choose freely whether or not to exercise its jurisdiction."<sup>103</sup>

54. Mindful of the precise scope of Mexico's appeal<sup>104</sup>, we express no view as to whether there may be other circumstances in which legal impediments could exist that would preclude a panel from ruling on the merits of the claims that are before it. In the present case, Mexico argues that the United States' claims under Article III of the GATT 1994 are inextricably linked to a broader dispute<sup>105</sup>, and

<sup>101</sup>(emphasis added) Thus, the Appellate Body has explained that there is "little in the DSU that explicitly limits the rights of WTO Members to bring an action". (Appellate Body Report, *EC – Export Subsidies on Sugar*, para. 312) In a similar vein, the Appellate Body has also observed that a WTO "Member has broad discretion in deciding whether to bring a case against another Member under the DSU." (Appellate Body Report, *EC – Bananas III*, para. 135) Further, Article 3.7 of the DSU states that "[b]efore bringing a case, a Member shall exercise its *judgement* as to whether action under these procedures would be fruitful." (emphasis added) Finally, Article 3.10 of the DSU stipulates that "if a dispute arises, *all Members will engage* in these procedures *in good faith in an effort to resolve the dispute*." (emphasis added)

<sup>102</sup>Article 3.2 of the DSU provides that "[r]ecommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements."

Article 19.2 of the DSU states that "[i]n accordance with paragraph 2 of Article 3, in their findings and recommendations, the panel and Appellate Body cannot add to or diminish the rights and obligations provided in the covered agreements."

<sup>103</sup>Panel Report, para. 7.8.

<sup>104</sup>See *supra*, para. 44 and footnote 85 *thereto*.

<sup>105</sup>Mexico's appellant's submission, para. 73.

that only a NAFTA panel could resolve the dispute as a whole.<sup>106</sup> Nevertheless, Mexico does not take issue with the Panel's finding that "neither the subject matter nor the respective positions of the parties are identical in the dispute under the NAFTA ... and the dispute before us."<sup>107</sup> Mexico also stated that it could not identify a legal basis that would allow it to raise, in a WTO dispute settlement proceeding, the market access claims it is pursuing under the NAFTA.<sup>108</sup> It is furthermore undisputed that no NAFTA panel as yet has decided the "broader dispute" to which Mexico has alluded. Finally, we note that Mexico has expressly stated that the so-called "exclusion clause" of Article 2005.6 of the NAFTA<sup>109</sup> had not been "exercised".<sup>110</sup> We do not express any view on whether a legal impediment

<sup>106</sup>In its appellant's submission, Mexico explains that, in 1998, it initiated NAFTA dispute settlement proceedings because it was of the view that the United States was acting inconsistently with its obligation under the NAFTA relating to market access for Mexican sugar to the United States market. In 2000, Mexico requested the establishment of a panel under Article 2008 of the NAFTA. Subsequently, according to Mexico, it appointed its panelists to the NAFTA panel; however, the United States failed to appoint its panelists and also instructed the United States' Section of the NAFTA Secretariat not to appoint panelists. (Mexico's appellant's submission, paras. 15-27)

As a result, "[n]o further step could be taken by Mexico to form the NAFTA panel and have its grievance heard." (Mexico's appellant's submission, para. 28 ("No había otros pasos que México pudiera dar conforme a las disposiciones del tratado para conseguir integrar el panel y que su agravio fuera oído")) Mexico explains that it subsequently adopted the measures at issue in this dispute "to compel the United States to comply with its obligations and [to] protect [Mexico's] own legal and commercial interests." (*Ibid.*, para. 42 ("para mover a Estados Unidos a cumplir con sus obligaciones, a la vez que protegí [los] legítimos intereses jurídicos y comerciales [de México]"))

The United States disputes these arguments by Mexico and argues that "the Appellate Body [should not] undertake itself to assess the correctness of Mexico's assertions as to what the NAFTA requires." (United States' appellee's submission, para. 18) It submits that, if the WTO dispute settlement were to "become a forum for WTO Members to ... obtain findings as to the consistency of another Member's measure with any non-WTO agreement", this "would be a departure from the function the WTO dispute settlement system was established to serve". (*Ibid.*, para. 41) The United States also submits that "it is in full compliance with its obligations under NAFTA's dispute settlement mechanism." (*Ibid.*, para. 84)

While these NAFTA issues have been described by the parties by way of background to the WTO dispute, neither the Panel or the Appellate Body was called upon to examine these issues.

<sup>107</sup>Panel Report, para. 7.14. The Panel noted, in this regard, that:

[i]n the present case, the complaining party is the United States and the measures in dispute are allegedly imposed by Mexico. In the NAFTA case, the situation appears to be the reverse: the complaining party is Mexico and the measures in dispute are allegedly imposed by the United States. As for the subject matter of the claims, in the present case the United States is alleging discriminatory treatment against its products resulting from internal taxes and other internal measures imposed by Mexico. In the NAFTA case, instead, Mexico is arguing that the United States is violating its market access commitments under the NAFTA.

<sup>108</sup>Mexico's response to questioning at the oral hearing.

<sup>109</sup>Article 2005.6 of the NAFTA provides:

Once dispute settlement procedures have been initiated under Article 2007 or dispute settlement proceedings have been initiated under the GATT, the forum selected shall be used to the exclusion of the other, unless a Party makes a request pursuant to paragraph 3 or 4. (emphasis added)

<sup>110</sup>Mexico's response to questioning at the oral hearing.

to the exercise of a panel's jurisdiction would exist in the event that features such as those mentioned above were present.<sup>111</sup> In any event, we see no legal impediments applicable in this case.

55. Finally, as we understand it, Mexico's position is that the "applicability" of its WTO obligations towards the United States would be "call[ed] into question"<sup>112</sup> as a result of the United States having prevented Mexico, by an illegal act (namely, the alleged refusal by the United States to nominate panelists to the NAFTA panel), from having recourse to the NAFTA dispute settlement mechanism to resolve a bilateral dispute between Mexico and the United States regarding trade in sweeteners.<sup>113</sup> Specifically, Mexico refers to the ruling of the Permanent Court of International Justice (the "PCIJ") in the *Factory at Chorzów* case, and "calls into question the 'applicability' of its WTO obligations towards the United States in the context of this dispute".<sup>114</sup>

56. Mexico's arguments, as well as its reliance on the ruling in *Factory at Chorzów*, is misplaced. Even assuming, *arguendo*, that the legal principle reflected in the passage referred to by Mexico is applicable within the WTO dispute settlement system, we note that this would entail a determination whether the United States has acted consistently or inconsistently with its NAFTA obligations.<sup>115</sup> We see no basis in the DSU for panels and the Appellate Body to adjudicate non-WTO disputes. Article 3.2 of the DSU states that the WTO dispute settlement system "serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements". (emphasis added) Accepting Mexico's interpretation would imply that the WTO dispute settlement system could be used to determine rights and obligations outside the covered agreements. In light of the above, we do not see how the PCIJ's ruling in *Factory at Chorzów* supports Mexico's position in this case.

<sup>111</sup>In this context, Mexico has alluded to paragraph 7.38 of the Panel Report in *Argentina – Poultry Anti-Dumping Duties*. See also *supra*, footnote 86.

<sup>112</sup>Mexico's appellant's submission, para. 73 ("[es] cuestion[able]").

<sup>113</sup>See Panel Report, para. 7.14.

<sup>114</sup>Mexico's appellant's submission, para. 73 ("*cuestiona que sus obligaciones sean aplicables frente a Estados Unidos a luz del siguiente principio general del derecho internacional*"). The passage of the ruling that Mexico refers to reads as follows:

... one party cannot avail himself of the fact that the other has not fulfilled some obligation, or has not had recourse to some means of redress, if the former party has, by some illegal act, prevented the latter from fulfilling the obligation in question, or from having recourse to the tribunal which would have been open to him.

(Permanent Court of International Justice, *Factory at Chorzów (Germany v. Poland)* (Jurisdiction), 1927, PCIJ Series A, No. 9, p. 31) (underlining added by Mexico omitted)

<sup>115</sup>We also note that the ruling of the PCIJ in the *Factory at Chorzów* case relied on by Mexico was made in a situation in which the party objecting to the exercise of jurisdiction by the PCIJ was the party that had committed the act alleged to be illegal. In the present case, the party objecting to the exercise of jurisdiction by the Panel (Mexico) relies instead on an allegedly illegal act committed by the other party (the United States).

57. For all these reasons, we *uphold* the Panel's conclusion, in paragraphs 7.1, 7.18, and 9.1 of the Panel Report, that "under the DSU, it ha[d] no discretion to decline to exercise its jurisdiction in the case that ha[d] been brought before it." Having upheld this conclusion, we *find* it unnecessary to rule in the circumstances of this appeal on the propriety of exercising such discretion.<sup>116</sup>

#### V. Article XX(d) of the GATT 1994

##### A. Introduction

58. We turn now to Mexico's claim that the Panel erred in finding that the challenged measures are not justified under Article XX(d) of the GATT 1994. Before proceeding, we note that Mexico has not appealed the Panel's conclusion that the challenged measures are inconsistent with Article III of the GATT 1994.<sup>117</sup>

59. Mexico argued before the Panel that its "measures are 'necessary to secure compliance' by the United States with the United States' obligations under the NAFTA, an international agreement that is a law not inconsistent with the provisions of the GATT 1994."<sup>118</sup> The United States responded that "the NAFTA is not a 'law or regulation,' and Mexico's taxes are not 'necessary to secure compliance.'<sup>119</sup>

60. The Panel began its analysis by looking at the meaning of the terms "to secure compliance". According to the Panel, "to secure compliance" means "to *enforce* compliance".<sup>120</sup> The Panel noted that "the notion of enforcement contains a concept of action within a hierarchical structure that is associated with the relation between the state and its subjects".<sup>121</sup> It further observed that Article XX(d) "is concerned with action at a domestic rather than international level."<sup>122</sup> Based on this reasoning, the Panel concluded that "the phrase 'to secure compliance' in Article XX(d) does not apply to measures taken by a Member in order to induce another Member to comply with obligations owed to it under a non-WTO treaty."<sup>123</sup>

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<sup>116</sup>Panel Report, paras. 7.1 and 7.18.

<sup>117</sup>Therefore, we express no view on the Panel's interpretation of Article III in this case.

<sup>118</sup>Panel Report, para. 8.162 (referring to Mexico's first written submission to the Panel, paras. 117-118 and 125).

<sup>119</sup>*Ibid.*, para. 8.163.

<sup>120</sup>*Ibid.*, para. 8.175. (emphasis added)

<sup>121</sup>*Ibid.*, para. 8.178.

<sup>122</sup>*Ibid.*, para. 8.179.

<sup>123</sup>*Ibid.*, para. 8.181.

61. Having interpreted the terms "to secure compliance", the Panel proceeded to examine whether Mexico's measures are designed to secure compliance. The Panel explained that "when enforcement action is taken within a Member's legal system there will normally be no doubt, provided the action is pointed at the right target, that it will achieve that target."<sup>124</sup> In contrast, "the outcome of international countermeasures, such as those adopted by Mexico, is inherently unpredictable".<sup>125</sup> Therefore, the Panel reasoned, international countermeasures are "not eligible to be considered as measures 'to secure compliance' within the meaning of Article XX(d)."<sup>126</sup> The Panel added that "even if the assumption were to be made in the abstract that international countermeasures are potentially capable of qualifying as measures designed to secure compliance, the Panel's conclusion would be that Mexico has not established that its measures contribute to securing compliance in the circumstances of this case."<sup>127</sup> Thus, the Panel rejected Mexico's argument that "the challenged tax measures are *designed* to secure compliance by the United States with laws or regulations."<sup>128</sup>

62. The Panel then examined whether the challenged measures would fall within the meaning of the terms "laws or regulations" in Article XX(d). The Panel underscored the link between the terms "to secure compliance" and the terms "laws and regulations" as set out in Article XX(d). It indicated that the same reasoning that applies in determining whether Mexico's measures are measures "to secure compliance" must also apply in determining whether the measures are "laws or regulations" within the meaning of Article XX(d).<sup>129</sup> In the Panel's view, "the conclusion that these words refer to enforcement action within a particular domestic legal system, and that they do not extend to international action of the type taken by Mexico, necessarily applies to both parts of this expression."<sup>130</sup> The Panel further observed that, "even if it were to assume that the expression 'laws or regulations' in Article XX(d) could include international agreements such as the NAFTA, it would in any event conclude that, on the facts of the case, because of the uncertainty of their consequences, the challenged measures are not designed 'to secure compliance with laws or regulations which are not inconsistent with the provisions' of GATT 1994."<sup>131</sup>

63. Therefore, the Panel concluded that "Mexico has not demonstrated that the challenged measures are designed 'to secure compliance with laws or regulations', within the meaning of

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<sup>124</sup>Panel Report, para. 8.185.

<sup>125</sup>*Ibid.*, para. 8.186.

<sup>126</sup>*Ibid.*

<sup>127</sup>*Ibid.*

<sup>128</sup>*Ibid.*, para. 8.190. (original emphasis)

<sup>129</sup>*Ibid.*, para. 8.194.

<sup>130</sup>*Ibid.*

<sup>131</sup>*Ibid.*, para. 8.197.

Article XX(d) of the GATT 1994.<sup>132</sup> Having made this finding, the Panel did not consider that it needed to examine whether Mexico's measures are "necessary" within the meaning of Article XX(d)<sup>133</sup>, and whether the measures satisfy the requirements set out in the chapeau of Article XX.<sup>134</sup> Consequently, the Panel concluded that "Mexico has not established that the challenged measures are justified under Article XX of the GATT 1994."<sup>135</sup>

64. On appeal, Mexico seeks review of the Panel's conclusion that Mexico's measures are not justified under Article XX(d) of the GATT 1994. According to Mexico, the Panel incorrectly interpreted the terms "to secure compliance" as excluding international countermeasures<sup>136</sup>, and this error led the Panel to incorrectly interpret the terms "laws or regulations" in Article XX(d).<sup>137</sup> Mexico argues that the terms "laws or regulations" are "broad enough to include international agreements such as the NAFTA."<sup>138</sup> Mexico points out that "the use of the terms 'laws' and 'regulations' elsewhere in the GATT 1994 and in other WTO agreements does not demonstrate that such terms exclude international law rules."<sup>139</sup>

65. The United States responds that the Panel properly found that Mexico's measures are not justified under Article XX(d). It asserts that "the ordinary meaning of 'laws' and 'regulations' is that these are rules (e.g., in the form of a statute) issued by a government and not obligations under an international agreement."<sup>140</sup> The United States further explains that Mexico's interpretation of Article XX(d) is in conflict with Article 23 of the DSU, by allowing a WTO Member to take action outside the rules of the DSU to secure compliance with another Member's obligations under any international agreement, including the WTO agreements.<sup>141</sup> It would also undermine Article 22 of the DSU by "permit[ing] the suspension of concessions ... without DSB authorization and without any requirement to adhere to the rules established" in that provision.<sup>142</sup>

<sup>132</sup>Panel Report, para. 8.198.

<sup>133</sup>*Ibid.*, para. 8.202.

<sup>134</sup>*Ibid.*, para. 8.203.

<sup>135</sup>*Ibid.*, para. 8.204.

<sup>136</sup>Mexico's appellant's submission, para. 79 and footnote 49 thereto.

<sup>137</sup>*Ibid.*, para. 126.

<sup>138</sup>*Ibid.*, para. 129 ("significativamente amplia para incluir tratados internacionales, como el TLCAN").

<sup>139</sup>*Ibid.* ("el empleo de los términos 'leyes' y 'reglamentos' en el resto del GATT de 1994 y en otros Acuerdos de la OMC no demuestran que los tales términos excluyen las reglas del derecho internacional") (footnote omitted).

<sup>140</sup>United States' appellee's submission, para. 30 (referring to definitions in *Black's Law Dictionary*, (1990), p. 816).

<sup>141</sup>*Ibid.*, para. 37.

<sup>142</sup>*Ibid.*, para. 38. (footnote omitted)

B. *Analysis*

1. Are Mexico's Measures Justified under Article XX(d)?

66. Article XX(d) of the GATT 1994 reads:

*General Exceptions*

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, including those relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trade marks and copyrights, and the prevention of deceptive practices[.]

67. The Appellate Body explained, in *Korea – Various Measures on Beef*, that two elements must be shown "[f]or a measure, otherwise inconsistent with GATT 1994, to be justified provisionally under paragraph (d) of Article XX".<sup>143</sup> The first element is that "the measure must be one designed to 'secure compliance' with laws or regulations that are not themselves inconsistent with some provision of the GATT 1994", and the second is that "the measure must be 'necessary' to secure such compliance."<sup>144</sup> The Appellate Body also explained that "[a] Member who invokes Article XX(d) as a justification has the burden of demonstrating that these two requirements are met."<sup>145</sup>

68. In our view, the central issue raised in this appeal is whether the terms "to secure compliance with laws or regulations" in Article XX(d) of the GATT 1994 encompass WTO-inconsistent measures applied by a WTO Member to secure compliance with another WTO Member's obligations under an international agreement.

<sup>143</sup>Appellate Body Report, *Korea – Various Measures on Beef*, para. 157.

<sup>144</sup>*Ibid.*

<sup>145</sup>*Ibid.* (referring to Appellate Body Report, *US – Gasoline*, pp. 22-23; DSR 1996:1, 3, at 20-21; Appellate Body Report, *US – Wool Shirts and Blouses*, pp. 14-16; DSR 1997:1, 323, at 335-337; and GATT Panel Report, *US – Section 337*, para. 5.27).

69. In order to answer this question, we consider it more helpful to begin our analysis with the terms "laws or regulations" in Article XX(d) (which we consider to be pivotal here) rather than to begin with the analysis of the terms "to secure compliance", as did the Panel. The terms "laws or regulations" are generally used to refer to domestic laws or regulations. As Mexico and the United States note, previous GATT and WTO disputes in which Article XX(d) has been invoked as a defence have involved domestic measures.<sup>146</sup> Neither disputes that the expression "laws or regulations" encompasses the rules adopted by a WTO Member's legislative or executive branches of government. We agree with the United States that one does not immediately think about international law when confronted with the term "laws" in the plural.<sup>147</sup> Domestic legislative or regulatory acts sometimes may be intended to implement an international agreement. In such situations, the origin of the rule is international, but the implementing instrument is a domestic law or regulation.<sup>148</sup> In our view, the terms "laws or regulations" refer to rules that form part of the domestic legal system of a WTO Member.<sup>149</sup> Thus, the "laws or regulations" with which the Member invoking Article XX(d) may seek to secure compliance do not include obligations of *another* WTO Member under an international agreement.

70. The illustrative list of "laws or regulations" provided in Article XX(d) supports the conclusion that these terms refer to rules that form part of the domestic legal system of a WTO Member.<sup>150</sup> This list includes "[laws or regulations] relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trade marks and copyrights, and the prevention of deceptive practices". These matters are typically the subject of domestic laws or regulations, even though some of these matters may also be the subject of

<sup>146</sup>United States' appellee's submission, footnote 62 to para. 39; Mexico's response to questioning at the oral hearing.

<sup>147</sup>Panel Report, footnote 419 to para. 8.193; United States' appellee's submission, para. 31.

<sup>148</sup>In some WTO Members, certain international rules may have direct effect within their domestic legal systems without requiring implementing legislation. In such circumstances, these rules also become part of the domestic law of that Member.

<sup>149</sup>The European Communities notes that:

[i]t is entirely possible that international agreements may be incorporated into the domestic legal order in such a way that they can be invoked as against individuals, and enforce[d] against them. If this is the case, the international agreement, albeit international in origin, may be regarded as having become an integral part of the domestic legal order of such Member, and thus a law or regulation within the meaning of Article XX (d) [of the] GATT [1994].

(European Communities' third participant's submission, para. 41)

<sup>150</sup>The participants agree that the list in Article XX(d) is not exhaustive. (See Mexico's response to Question 67 posed by the Panel after the second Panel meeting; Panel Report, p. C-61; United States' response to Question 31 posed by the Panel after the first Panel meeting; Panel Report, p. C-42; and United States' response to Question 67 posed by the Panel after the second Panel meeting; Panel Report, pp. C-79-C-80)

international agreements. The matters listed as examples in Article XX(d) involve the regulation by a government of activity undertaken by a variety of economic actors (e.g., private firms and State enterprises), as well as by government agencies. For example, matters "relating to customs enforcement" will generally involve rights and obligations that apply to importers or exporters, and matters relating to "the protection of patents, trade marks and copyrights" will usually regulate the use of these rights by the intellectual property right holders and other private actors.<sup>151</sup> Thus, the illustrative list reinforces the notion that the terms "laws or regulations" refer to rules that form part of the domestic legal system of a WTO Member and do not extend to the international obligations of another WTO Member.<sup>152</sup>

71. Our understanding of the terms "laws or regulations" is consistent with the context of Article XX(d). As the United States points out<sup>153</sup>, other provisions of the covered agreements refer expressly to "international obligations" or "international agreements". For example, paragraph (h) of Article XX refers to "obligations under any intergovernmental commodity agreement". The express language of paragraph (h) would seem to contradict Mexico's suggestion that international agreements are implicitly included in the terms "laws or regulations".<sup>154</sup> The United States and China also draw our attention to Article X:1 of the GATT 1994<sup>155</sup>, which refers to "[l]aws, regulations, judicial decisions and administrative rulings" and to "[a]greements affecting international trade policy which are in force between a government ... of any Member and the government ... of any other Member". Thus, a distinction is drawn in the same provision between "laws [and] regulations" and "international agreements". Such a distinction would have been unnecessary if, as Mexico argues, the terms "laws" and "regulations" were to encompass international agreements that have not been incorporated, or do not have direct effect in, the domestic legal system of the respective WTO Member. Thus, Articles X:1 and XX(h) of the GATT 1994 do not lend support to interpreting the terms "laws or

<sup>151</sup>European Communities' third participant's submission, para. 38.

<sup>152</sup>The United States also points out that the terms "laws or regulations" are qualified by the requirement that they not be "inconsistent" with the GATT 1994. The United States explains that the word "inconsistent" appears elsewhere in the GATT 1994 in connection with domestic measures. In contrast, when referring to treaty obligations, the WTO agreements use the word "conflict". (United States' appellee's submission, para. 33) In our view, this distinction supports the position that the terms "laws or regulations" refer to the rules that are part of the domestic legal system of a WTO Member, including international rules that have been incorporated or have direct effect in a particular domestic legal system.

<sup>153</sup>United States' appellee's submission, para. 34.

<sup>154</sup>If an international commodity agreement contains GATT-inconsistent provisions, Article XX(h) would still serve the purpose of justifying such an agreement, even if it could not be justified under Article XX(d).

<sup>155</sup>United States' appellee's submission, para. 35; China's third participant's submission, para. 21.

regulations" in Article XX(d) as including the international obligations of a Member other than that invoking the provision.<sup>156</sup>

72. We turn to the terms "to secure compliance", which were the focus of the Panel's reasoning and are the focus of Mexico's appeal. The terms "to secure compliance" speak to the types of measures that a WTO Member can seek to justify under Article XX(d). They relate to the design of the measures sought to be justified.<sup>157</sup> There is no justification under Article XX(d) for a measure that is not designed "to secure compliance" with a Member's laws or regulations. Thus, the terms "to secure compliance" do not expand the scope of the terms "laws or regulations" to encompass the international obligations of another WTO Member. Rather, the terms "to secure compliance" circumscribe the scope of Article XX(d).

73. Mexico takes issue with several aspects of the Panel's reasoning related to the interpretation of the terms "to secure compliance". We recall that, according to the Panel, "[t]he context in which the expression is used makes clear that 'to secure compliance' is to be read as meaning to enforce compliance."<sup>158</sup> The Panel added that, in contrast to enforcement action taken within a Member's legal system, "the effectiveness of [Mexico's] measures in achieving their stated goal—that of bringing about a change in the behaviour of the United States—seems ... to be inescapably uncertain."<sup>159</sup> Thus, the Panel concluded that "the outcome of international countermeasures, such as those adopted by Mexico, is inherently unpredictable".<sup>160</sup>

74. It is Mexico's submission that the Panel erred in requiring a degree of certainty as to the results achieved by the measure sought to be justified.<sup>161</sup> Mexico also asserts that the Panel, in its reasoning, incorrectly relied on the Appellate Body Report in *US – Gambling*.<sup>162</sup> We agree with

<sup>156</sup>The Panel noted that there are examples of international "regulations" within the WTO agreements themselves. The Panel cited, as examples, Article VI of the *Marrakesh Agreement Establishing the World Trade Organization* that refers to "regulations" to be adopted by the Ministerial Conference, and Article VII that refers to "financial regulations" to be adopted by the General Council and to the "regulations" of the GATT 1947. (Panel Report, footnotes 423 and 424 to para. 8.195) Article XXIV of the GATT 1994 also uses the term "regulations" when referring to rules applied by free trade areas or customs unions. Nevertheless, we agree with Japan that, in these instances, the context makes it clear that the regulations are international in character. (Japan's third participant's submission, paras. 17-19)

<sup>157</sup>Appellate Body Report, *Korea – Various Measures on Beef*, para. 157.

<sup>158</sup>Panel Report, para. 8.175.

<sup>159</sup>*Ibid.*, para. 8.185.

<sup>160</sup>*Ibid.*, para. 8.186. See also Mexico's appellant's submission, paras. 104-116.

<sup>161</sup>The European Communities and Japan agree with Mexico that the Panel erred in implying that whether a measure falls within the meaning of the phrase "to secure compliance" depends on the degree of certainty that the measure will achieve its intended results. (European Communities' third participant's submission, para. 26; Japan's third participant's submission, para. 10)

<sup>162</sup>Panel Report, paras. 8.187-8.188 (referring to Appellate Body Report, *US – Gambling*, para. 317).

Mexico that the *US – Gambling* Report does not support the conclusion that the Panel sought to draw from it. The statement to which the Panel referred was made in the context of the examination of the "necessity" requirement in Article XIV(a) of the *General Agreement on Trade in Services*, and did not relate to the terms "to secure compliance". As the Appellate Body has explained previously, "the contribution made by the compliance measure to the enforcement of the law or regulation at issue"<sup>163</sup> is one of the factors that must be weighed and balanced to determine whether a measure is "necessary" within the meaning of Article XX(d). A measure that is not suitable or capable of securing compliance with the relevant laws or regulations will not meet the "necessity" requirement. We see no reason, however, to derive from the Appellate Body's examination of "necessity", in *US – Gambling*, a requirement of "certainty" applicable to the terms "to secure compliance".<sup>164</sup> In our view, a measure can be said to be designed "to secure compliance" even if the measure cannot be guaranteed to achieve its result with absolute certainty.<sup>165</sup> Nor do we consider that the "use of coercion"<sup>166</sup> is a necessary component of a measure designed "to secure compliance". Rather, Article XX(d) requires that the design of the measure contribute "to secur[ing] compliance with laws or regulations which are not inconsistent with the provisions of" the GATT 1994.

75. Nevertheless, while we agree with Mexico that the Panel's emphasis on "certainty" and "coercion" is misplaced, we consider that Mexico's arguments miss the point. Even if "international countermeasures" could be described as intended "to secure compliance", what they seek "to secure compliance with"—that is, the international obligations of another WTO Member—would be outside the scope of Article XX(d). This is because "laws or regulations" within the meaning of Article XX(d) refer to the rules that form part of the domestic legal order of the WTO Member invoking the provision and do not include the international obligations of *another* WTO Member.

<sup>163</sup>Appellate Body Report, *Korea – Various Measures on Beef*, para. 164.

<sup>164</sup>We note that, at the request of the United States, the Panel clarified in the interim review phase that:

... its reasoning does not focus on whether the achievement of Mexico's objective through the measures at issue is certain or uncertain. Rather, the Panel considers that international countermeasures (as the ones allegedly imposed by Mexico) are intrinsically unable to secure compliance of laws and regulations. In contrast, national measures are, beyond particular factual considerations, usually in a position to achieve [] that objective, through the use of coercion, if necessary.

(Panel Report, para. 6.12) (original italics; underlining added)

<sup>165</sup>The European Communities notes that "even within the domestic legal order of WTO Members, enforcement of laws and regulations may not simply be taken for granted, but may depend on numerous factors". (European Communities' third participant's submission, para. 28)

<sup>166</sup>Panel Report, para. 8.178.

76. Mexico finds support for its interpretation in the Appellate Body's rulings in *US – Shrimp* and *US – Shrimp (Article 21.5 – Malaysia)*.<sup>167</sup> We fail to see how these rulings support Mexico's position. In those cases, the United States sought to justify its measures under Article XX(g) of the GATT 1994, and the measures at issue were domestic laws and regulations of the United States.<sup>168</sup> The reference to the Inter-American Convention for the Protection and Conservation of Sea Turtles (the "Inter-American Convention") was made in the context of the examination of whether the measures constituted "a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail" for purposes of the chapeau of Article XX.<sup>169</sup> The United States, in those cases, did not argue that its measures were justified under Article XX(d) because they were intended to secure compliance with the obligations of another Member under the Inter-American Convention. In the present case, Mexico seeks to justify its measures under paragraph (d) of Article XX, and not under paragraph (g). Moreover, Mexico not only refers to the NAFTA in relation to the chapeau of Article XX, but also seeks justification for its measures under paragraph (d) on the basis that they are allegedly intended to secure compliance with the United States' NAFTA obligations.

77. We observe, furthermore, that Mexico's interpretation of Article XX(d) disregards the fact that the GATT 1994 and the DSU specify the actions that a WTO Member may take if it considers that another WTO Member has acted inconsistently with its obligations under the GATT 1994 or any of the other covered agreements. As the United States points out<sup>170</sup>, Mexico's interpretation of the terms "laws or regulations" as including international obligations of another WTO Member would logically imply that a WTO Member could invoke Article XX(d) to justify also measures designed "to secure compliance" with that other Member's WTO obligations. By the same logic, such action under Article XX(d) would evade the specific and detailed rules that apply when a WTO Member seeks to take countermeasures in response to another Member's failure to comply with rulings and recommendations of the DSB pursuant to Article XXIII:2 of the GATT 1994 and Articles 22 and 23 of the DSU.<sup>171</sup> Mexico's interpretation would allow WTO Members to adopt WTO-inconsistent measures based upon a *unilateral* determination that another Member has breached its WTO obligations, in contradiction with Articles 22 and 23 of the DSU and Article XXIII:2 of the GATT 1994.

<sup>167</sup>Mexico's appellant's submission, paras. 174-178.

<sup>168</sup>See Appellate Body Report, *US – Shrimp*, paras. 2-6.

<sup>169</sup>See *ibid.*, paras. 169-172; and Appellate Body Report, *US – Shrimp (Article 21.5 – Malaysia)*, para. 128. See also United States' appellee's submission, para. 108.

<sup>170</sup>United States' appellee's submission, para. 37.

<sup>171</sup>Mexico's interpretation would also undermine the limitations in paragraphs 3 and 4 of Article 22 as to the magnitude and the trade sectors in which such countermeasures could be taken. (*Ibid.*, paras. 37-38)

78. Finally, even if the terms "laws or regulations" do not go so far as to encompass the WTO agreements, as Mexico argues<sup>172</sup>, Mexico's interpretation would imply that, in order to resolve the case, WTO panels and the Appellate Body would have to assume that there is a violation of the relevant international agreement (such as the NAFTA) by the complaining party, or they would have to assess whether the relevant international agreement has been violated. WTO panels and the Appellate Body would thus become adjudicators of non-WTO disputes.<sup>173</sup> As we noted earlier<sup>174</sup>, this is not the function of panels and the Appellate Body as intended by the DSU.<sup>175</sup>

79. For these reasons, we agree with the Panel that Article XX(d) is not available to justify WTO-inconsistent measures that seek "to secure compliance" by another WTO Member with that other Member's international obligations. In sum, while we agree with the Panel's conclusion, several aspects of our reasoning set out above differ from the Panel's own reasoning. First, we conclude that the terms "laws or regulations" cover rules that form part of the domestic legal system of a WTO Member, including rules deriving from international agreements that have been incorporated into the domestic legal system of a WTO Member or have direct effect according to that WTO Member's legal system.<sup>176</sup> Second, we have found that Article XX(d) does not require the "use of coercion" nor that the measure sought to be justified results in securing compliance with absolute certainty. Rather, Article XX(d) requires that the measure be designed "to secure compliance with laws or regulations which are not inconsistent with the provisions of" the GATT 1994.<sup>177</sup> Finally, we do not endorse the Panel's reliance on the Appellate Body's interpretation in *US – Gambling* of the term "necessary" to interpret the terms "to secure compliance" in Article XX(d).<sup>178</sup>

<sup>172</sup>At the oral hearing, Mexico argued that the terms "laws or regulations" would not include the WTO agreements because the latter are *lex specialis*.

<sup>173</sup>Article 3.2 of the DSU states that the WTO's dispute settlement system "serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements". (emphasis added)

<sup>174</sup>See *supra*, para. 56.

<sup>175</sup>We note that, in its analysis, the Panel also referred to the negotiating history of the GATT 1947, and particularly to the rejection of a proposal presented by India during the negotiations on the International Trade Organization (the "ITO") Charter according to which Members would be permitted to justify, on a temporary basis, retaliatory measures under Article XX. (See Panel Report, para. 8.176 (referring to ITO Doc. E/PC/T/180 (19 August 1947), p. 97; and "Havana Charter for an International Trade Organization", United Nations Conference on Trade and Employment, Final Act and Related Documents (Lake Success, New York, April 1948), pp. 33-34)

<sup>176</sup>See *supra*, paras. 69-71.

<sup>177</sup>See *supra*, para. 74.

<sup>178</sup>See *supra*, para. 74.

80. Therefore, we *uphold*, albeit for different reasons, the Panel's conclusion, in paragraph 8.198 of the Panel Report, that Mexico's measures do not constitute measures "to secure compliance with laws or regulations", within the meaning of Article XX(d) of the GATT 1994.

2. Mexico's Request to Complete the Analysis

81. Mexico requests the Appellate Body to complete the analysis by examining whether Mexico's measures are "necessary", within the meaning of Article XX(d) of the GATT 1994, and meet the requirements of the chapeau of that Article.<sup>179</sup> Mexico's request is premised on the Appellate Body reversing the Panel's conclusion that the measures are not designed "to secure compliance with laws or regulations" within the meaning of Article XX(d). We have upheld the Panel's conclusion that Mexico's measures do not constitute measures "to secure compliance with laws or regulations" within the meaning of Article XX(d) of the GATT 1994. Therefore, the premise on which Mexico's request is predicated is not fulfilled and, consequently, it is not necessary for us to complete the analysis as requested by Mexico.<sup>180</sup>

3. Mexico's Claim under Article 11 of the DSU<sup>181</sup>

82. Mexico argues, "separately and in addition"<sup>182</sup> to the previous errors, that the Panel failed to make "an objective assessment of the facts", as required by Article 11 of the DSU, in finding that "Mexico has not established that its measures contribute to securing compliance in the circumstances of this case."<sup>183</sup> Mexico argues that "[t]he evidence on the record demonstrates that the effects of the measures at issue have contributed to securing compliance in the circumstances of this case, by changing the dynamic of the NAFTA dispute and forcing the United States to pay attention to

<sup>179</sup>Mexico's appellant's submission, para. 138.

<sup>180</sup>See, for example, Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 74.

<sup>181</sup>In its Notice of Appeal, Mexico claimed that the Panel "failed to make an objective assessment of the matter before it, including the facts of the case, inconsistently with its obligation under Article 11 of the DSU, with respect to Mexico's request for determinations of fact, status and relevance of the NAFTA dispute between the parties." (Mexico's Notice of Appeal (attached as Annex I to this Report), para. 4 (referring to Panel Report, paras. 8.231 and 8.232) (footnote omitted)) Mexico also asserted that "in concluding that international countermeasures cannot qualify for consideration as measures designed to 'secure compliance' within the meaning of Article XX(d) of the GATT 1994, the Panel improperly increased the obligations of WTO Members and reduced the rights of Members under the covered agreements." (*Ibid.*, para. 5 (referring to Panel Report, paras. 8.181 and 8.186) (footnote omitted)) Mexico did not offer arguments to support these two claims in its appellant's submission. In response to questioning at the oral hearing, Mexico confirmed that it did not intend to pursue these claims further.

<sup>182</sup>Mexico's appellant's submission, heading III.E ("independiente y adicional").

<sup>183</sup>Panel Report, paragraph 8.186. See also, Mexico's Notice of Appeal, para. 3.

Mexico's grievances."<sup>184</sup> The United States submits that, contrary to Mexico's contention, the Panel did not "ignore" arguments or evidence submitted by Mexico.<sup>185</sup> The United States further explains that, in any event, Mexico's claim under Article 11 of the DSU "appears to be no more than a reiteration of its legal arguments that its ... measures are designed to 'secure compliance'".<sup>186</sup>

83. In Section B.1 above, we held that Mexico's measures do not constitute measures "to secure compliance with laws or regulations", within the meaning of Article XX(d) of the GATT 1994. Therefore, Mexico's claim under Article 11 of the DSU is predicated on an interpretation of Article XX(d) of the GATT 1994 that we have found to be incorrect. Since Mexico's measures cannot be justified under Article XX(d) as a *matter of law*, we reject Mexico's claim under Article 11 of the DSU.

4. Conclusion

84. For the reasons set out above, we *uphold* the Panel's conclusion, in paragraphs 8.204 and 9.3 of the Panel Report, that "Mexico has not established that the challenged measures are justified under Article XX of the GATT 1994".

**VI. Findings and Conclusions**

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

- (a) upholds the Panel's conclusion, in paragraphs 7.1, 7.18, and 9.1 of the Panel Report, that, "under the DSU, it ha[d] no discretion to decline to exercise its jurisdiction in the case that ha[d] been brought before it";
- (b) upholds the Panel's conclusion, in paragraph 8.198 of the Panel Report, that Mexico's measures do not constitute measures "to secure compliance with laws or regulations", within the meaning of Article XX(d) of the GATT 1994;
- (c) rejects Mexico's claim that the Panel failed to fulfil its obligations under Article 11 of the DSU, in finding, in paragraph 8.186 of the Panel Report, that "Mexico has not established that its measures contribute to securing compliance in the circumstances of this case"; and

<sup>184</sup>Mexico's appellant's submission, para. 167 ("*Las pruebas en el expediente demuestran que las medidas en cuestión no están desprovistas de efectos que contribuyen a lograr la observancia en las circunstancias de este caso, cambiando la dinámica en la controversia derivada del TLCAN y forzando a Estados Unidos a prestar atención a los agravios de México*").

<sup>185</sup>United States' appellee's submission, para. 118.

<sup>186</sup>*Ibid.*

(d) as a consequence, upholds the Panel's conclusion, in paragraphs 8.204 and 9.3 of the Panel Report, that "Mexico has not established that the challenged measures are justified under Article XX of the GATT 1994".

86. The Appellate Body recommends that the Dispute Settlement Body request Mexico to bring the measures that were found in the Panel Report to be inconsistent with the *General Agreement on Tariff and Trade 1994* into conformity with its obligations under that Agreement.

Signed in the original in Geneva this 8th day of February 2006 by:

\_\_\_\_\_  
Yasuhei Taniguchi  
Presiding Member

\_\_\_\_\_  
Merit E. Janow  
Member

\_\_\_\_\_  
Giorgio Sacerdoti  
Member

ANNEX I

**WORLD TRADE  
ORGANIZATION**

**WT/DS308/10**  
6 December 2005  
(05-5832)

Original: Spanish

**MEXICO – TAX MEASURES ON SOFT DRINKS AND  
OTHER BEVERAGES**

Notification of an Appeal by Mexico under Article 16.4 and Article 17 of the  
Understanding on Rules and Procedures Governing the Settlement of  
Disputes (DSU) and Rule 20(1) of the *Working  
Procedures for Appellate Review*

The following notification dated 6 December 2005, from the delegation of Mexico, is being circulated to Members.

Pursuant to Article 16 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") and Rule 20 of the *Working Procedures for Appellate Review*, Mexico hereby notifies its decision to appeal to the Appellate Body certain issues of law dealt with in the Report of the Panel on *Mexico – Tax Measures on Soft Drinks and Other Beverages* (WT/DS308/R) (the "Panel Report") and certain legal interpretations developed by the Panel in this dispute.

1. Mexico seeks review by the Appellate Body of the Panel's legal conclusion that it has no discretion to decline to exercise jurisdiction in this case and its determination that, even if it had such discretion, the facts in the record do not justify a refusal by the Panel to exercise jurisdiction in this case. This conclusion is in error and is based on erroneous findings on issues of law and related legal interpretations concerning Articles 3, 7, 11 and 19 of the DSU and Articles XXII and XXIII of the GATT 1994. These errors are contained, *inter alia*, in paragraphs 7.1 to 7.18, 8.2.15 to 8.2.30 and 9.1 of the Panel Report.

2. Mexico seeks review by the Appellate Body of the Panel's legal conclusion that the challenged tax measures are not justified under Article XX of the GATT 1994 as measures necessary to secure United States compliance with laws or regulations which are not inconsistent with the provisions of the GATT 1994. This conclusion is in error and is based on erroneous findings on issues of law and related legal interpretations concerning Article XX of the GATT 1994. Paragraphs 8.168 to 8.204 and 9.3 of the Panel Report, among others, contain such errors, including the following:

- (a) The Panel's interpretation and application of the expression "to secure compliance" in Article XX(d) of the GATT 1994 and its conclusion that it does not apply to measures taken by a Member in order to induce another Member to comply with obligations owed to it under a non-WTO treaty.<sup>1</sup>
  - (b) The Panel's conclusion that the challenged tax measures "are not designed to secure compliance" within the meaning of Article XX(d) of the GATT 1994 and are not eligible for consideration under Article XX(d) of the GATT 1994.<sup>2</sup>
  - (c) The Panel's interpretation and application of the phrase "laws or regulations" contained in Article XX(d) of the GATT 1994 and its conclusion that this phrase does not cover international treaties such as NAFTA.<sup>3</sup>
  - (d) The Panel's failure to consider whether the Mexican measures are "necessary" to secure compliance with a law that is not inconsistent with the provisions of the GATT 1994.<sup>4</sup>
3. Mexico seeks review by the Appellate Body, in the light of DSU Article 11, of the Panel's conclusion that "Mexico has not established that its measures contribute to securing compliance in the circumstances of this case".<sup>5</sup> This conclusion does not reflect an objective approach to analysis of the available evidence on the effects of the Mexican measures, and is inconsistent with the treatment given by the Panel to relevant evidence. Accordingly, this conclusion is inconsistent with the Panel's duty to make an objective assessment of the matter before it.
  4. Mexico considers that the Panel also failed to make an objective assessment of the matter before it, including the facts of the case, inconsistently with its obligation under Article 11 of the DSU, with respect to Mexico's request for determinations of fact, status and relevance of the NAFTA dispute between the parties.<sup>6</sup>
  5. Mexico also considers that, in concluding that international countermeasures cannot qualify for consideration as measures designed to "secure compliance" within the meaning of Article XX(d) of the GATT 1994,<sup>7</sup> the Panel improperly increased the obligations of WTO Members and reduced the rights of Members under the covered agreements.
  6. In the event that the Appellate Body reverses the Panel's conclusion that Mexico's tax measures are not justified under Article XX(d) of the GATT 1994, Mexico requests that the Appellate Body complete the legal analysis under Article XX of the GATT 1994.

Those provisions of the covered agreements which Mexico considers the Panel to have interpreted or applied erroneously include Articles XX, XXII and XXIII of the GATT 1994 and Articles 3, 7, 11 and 19 of the DSU.

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<sup>1</sup> Panel Report, paragraphs 8.170 to 8.181.

<sup>2</sup> Panel Report, paragraphs 8.182 to 8.190 and 8.197 to 8.198.

<sup>3</sup> Panel Report, paragraphs 8.191 to 8.197.

<sup>4</sup> Panel Report, paragraphs 8.199 to 8.202.

<sup>5</sup> Panel Report, paragraph 8.186.

<sup>6</sup> Panel Report, paragraphs 8.231 and 8.232.

<sup>7</sup> Panel Report, paragraphs 8.181 and 8.186.



**World Trade Organization**

**Brazil – Measures Affecting Imports of Retreaded Tyres**

**Report of the Appellate Body, 3 December 2007**

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Short Title	Full case title and citation
<i>Australia – Salmon</i>	Appellate Body Report, <i>Australia – Measures Affecting Importation of Salmon</i> , WT/DS18/AB/R, adopted 6 November 1998, DSR 1998:VIII, 3327
<i>Brazil – Retreaded Tyres</i>	Panel Report, <i>Brazil – Measures Affecting Imports of Retreaded Tyres</i> , WT/DS332/R, circulated to WTO Members 12 June 2007
<i>Canada – Dairy</i>	Appellate Body Report, <i>Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products</i> , WT/DS103/AB/R, WT/DS113/AB/R and Corr.1, adopted 27 October 1999, DSR 1999:V, 2057
<i>Canada – Wheat Exports and Grain Imports</i>	Appellate Body Report, <i>Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain</i> , WT/DS276/AB/R, adopted 27 September 2004, DSR 2004:VI, 2739
<i>Chile – Price Band System (Article 21.5 – Argentina)</i>	Appellate Body Report, <i>Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products – Recourse to Article 21.5 of the DSU by Argentina</i> , WT/DS207/AB/RW, adopted 22 May 2007
<i>Dominican Republic – Import and Sale of Cigarettes</i>	Appellate Body Report, <i>Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes</i> , WT/DS302/AB/R, adopted 19 May 2005, DSR 2005:XV, 7367
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<i>EC – Asbestos</i>	Appellate Body Report, <i>European Communities – Measures Affecting Asbestos and Asbestos-Containing Products</i> , WT/DS135/AB/R, adopted 5 April 2001, DSR 2001:VII, 3243
<i>EC – Asbestos</i>	Panel Report, <i>European Communities – Measures Affecting Asbestos and Asbestos-Containing Products</i> , WT/DS135/R and Add.1, adopted 5 April 2001, as modified by Appellate Body Report, WT/DS135/AB/R, DSR 2001:VIII, 3305
<i>EC – Bed Linen (Article 21.5 – India)</i>	Appellate Body Report, <i>European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by India</i> , WT/DS141/AB/RW, adopted 24 April 2003, DSR 2003:III, 965
<i>EC – Export Subsidies on Sugar</i>	Appellate Body Report, <i>European Communities – Export Subsidies on Sugar</i> , WT/DS265/AB/R, WT/DS266/AB/R, WT/DS283/AB/R, adopted 19 May 2005, DSR 2005:XIII, 6365
<i>EC – Hormones</i>	Appellate Body Report, <i>EC Measures Concerning Meat and Meat Products (Hormones)</i> , WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:1, 135
<i>EC – Sardines</i>	Appellate Body Report, <i>European Communities – Trade Description of Sardines</i> , WT/DS231/AB/R, adopted 23 October 2002, DSR 2002:VIII, 3359
<i>EC – Selected Customs Matters</i>	Appellate Body Report, <i>European Communities – Selected Customs Matters</i> , WT/DS315/AB/R, adopted 11 December 2006
<i>EC – Tube or Pipe Fittings</i>	Appellate Body Report, <i>European Communities – Anti-Dumping Duties on Malleable Cast Iron Tube or Pipe Fittings from Brazil</i> , WT/DS219/AB/R, adopted 18 August 2003, DSR 2003:VI, 2613
<i>Japan – Agricultural Products II</i>	Appellate Body Report, <i>Japan – Measures Affecting Agricultural Products</i> , WT/DS76/AB/R, adopted 19 March 1999, DSR 1999:1, 277
<i>Japan – Alcoholic Beverages II</i>	Appellate Body Report, <i>Japan – Taxes on Alcoholic Beverages</i> , WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:1, 97

Short Title	Full case title and citation
Japan – Apples	Appellate Body Report, <i>Japan – Measures Affecting the Importation of Apples</i> , WT/DS245/AB/R, adopted 10 December 2003, DSR 2003:IX, 4391
Korea – Alcoholic Beverages	Appellate Body Report, <i>Korea – Taxes on Alcoholic Beverages</i> , WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999, DSR 1999:I, 3
Korea – Dairy	Appellate Body Report, <i>Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products</i> , WT/DS98/AB/R, adopted 12 January 2000, DSR 2000:I, 3
Korea – Various Measures on Beef	Appellate Body Report, <i>Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef</i> , WT/DS161/AB/R, WT/DS169/AB/R, adopted 10 January 2001, DSR 2001:I, 5
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Mexico – Taxes on Soft Drinks	Appellate Body Report, <i>Mexico – Tax Measures on Soft Drinks and Other Beverages</i> , WT/DS308/AB/R, adopted 24 March 2006
Turkey – Textiles	Appellate Body Report, <i>Turkey – Restrictions on Imports of Textile and Clothing Products</i> , WT/DS34/AB/R, adopted 19 November 1999, DSR 1999:VI, 2345
US – Carbon Steel	Appellate Body Report, <i>United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany</i> , WT/DS213/AB/R and Corr.1, adopted 19 December 2002, DSR 2002:IX, 3779
US – Corrosion-Resistant Steel Sunset Review	Appellate Body Report, <i>United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan</i> , WT/DS244/AB/R, adopted 9 January 2004, DSR 2004:I, 3
US – Gambling	Appellate Body Report, <i>United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services</i> , WT/DS285/AB/R and Corr.1, adopted 20 April 2005, DSR 2005:XII, 5663
US – Gambling	Panel Report, <i>United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services</i> , WT/DS285/R, adopted 20 April 2005, as modified by Appellate Body Report, WT/DS285/AB/R, DSR 2005:XII, 5797
US – Gasoline	Appellate Body Report, <i>United States – Standards for Reformulated and Conventional Gasoline</i> , WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:I, 3
US – Line Pipe	Panel Report, <i>United States – Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea</i> , WT/DS202/R, adopted 8 March 2002, as modified by Appellate Body Report, WT/DS202/AB/R, DSR 2002:IV, 1473
US – Oil Country Tubular Goods Sunset Reviews	Appellate Body Report, <i>United States – Sunset Reviews of Anti-Dumping Measures on Oil Country Tubular Goods from Argentina</i> , WT/DS268/AB/R, adopted 17 December 2004, DSR 2004:VII, 3257
US – Section 301 Trade Act	Panel Report, <i>United States – Sections 301-310 of the Trade Act of 1974</i> , WT/DS152/R, adopted 27 January 2000, DSR 2000:II, 815
US – Section 337 Tariff Act	GATT Panel Report, <i>United States Section 337 of the Tariff Act of 1930</i> , L/6439, adopted 7 November 1989, BISD 36S/345

Short Title	Full case title and citation
US – Shrimp	Appellate Body Report, <i>United States – Import Prohibition of Certain Shrimp and Shrimp Products</i> , WT/DS58/AB/R, adopted 6 November 1998, DSR 1998:VII, 2755
US – Shrimp (Article 21.5 – Malaysia)	Appellate Body Report, <i>United States – Import Prohibition of Certain Shrimp and Shrimp Products – Recourse to Article 21.5 of the DSU by Malaysia</i> , WT/DS58/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6481
US – Shrimp (Article 21.5 – Malaysia)	Panel Report, <i>United States – Import Prohibition of Certain Shrimp and Shrimp Products – Recourse to Article 21.5 of the DSU by Malaysia</i> , WT/DS58/RW, adopted 21 November 2001, upheld by Appellate Body Report, WT/DS58/AB/RW, DSR 2001:XIII, 6529
US – Wheat Gluten	Appellate Body Report, <i>United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities</i> , WT/DS166/AB/R, adopted 19 January 2001, DSR 2001:II, 717
US – Wool Shirts and Blouses	Appellate Body Report, <i>United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India</i> , WT/DS33/AB/R and Corr.1, adopted 23 May 1997, DSR 1997:I, 323

ABBREVIATIONS USED IN THIS REPORT

<b>Abbreviation</b>	<b>Description</b>
ABR	Associação Brasileira do Segmento de Reforma de Pneus (Brazilian Association of the Retreading Industry)
ABR Report	Report of the ABR on tyre retreading activities in Brazil, 26 May 2006 (Exhibit BRA-95)
CONAMA	Conselho Nacional do Meio Ambiente (National Council for the Environment of the Ministry of the Environment)
CONAMA Resolution 258/1999	CONAMA Resolution No. 258 of 26 August 1999 (Exhibits BRA-4 and EC-47)
CRTA	Committee on Regional Trade Agreements
DSB	Dispute Settlement Body
DSU	<i>Understanding on Rules and Procedures Governing the Settlement of Disputes</i>
Enabling Clause	<i>GATT 1979 Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries</i> , L/4903, 28 November 1979, BISD 26S/203
GATS	<i>General Agreement on Trade in Services</i>
GATT 1994	<i>General Agreement on Tariffs and Trade 1994</i>
Import Ban	Prohibition imposed by Brazil on imports of retreaded tyres
INMETRO	Instituto Nacional de Metrologia, Normalização e Qualidade Industrial (National Institute for Metrology, Standardization and Industrial Quality)
LAFIS	LAFIS Consultoria, Análises Sectoriais e de Empresas
MERCOSUR or Mercosur	Mercado Común del Sur (Southern Common Market) – a regional trade agreement between Brazil, Argentina, Uruguay, and Paraguay, founded in 1991 by the Treaty of Asunción, amended and updated by the 1994 Treaty of Ouro Preto
MERCOSUR exemption	Exemption from the Import Ban afforded by Brazil to imports of retreaded tyres originating in MERCOSUR countries
OECD	Organisation for Economic Co-operation and Development
Panel Report	Panel Report, <i>Brazil – Measures Affecting Imports of Retreaded Tyres</i>
Portaria SECEX 8/2000	Portaria SECEX No. 8 of 25 September 2000 (Exhibits BRA-71 and EC-26)
Portaria SECEX 14/2004	Portaria No. 14 of the SECEX, dated 17 November 2004 (Exhibits BRA-84 and EC-29)
SECEX	Secretaria de Comércio Exterior (Secretariat of Foreign Trade of the Brazilian Ministry of Development, Industry, and Foreign Trade)

<b>Abbreviation</b>	<b>Description</b>
<i>Understanding on Article XXIV of the GATT 1994</i>	<i>Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994</i>
<i>Working Procedures</i>	<i>Working Procedures for Appellate Review</i> , WT/AB/WP/5, 4 January 2005
WTO	World Trade Organization

WORLD TRADE ORGANIZATION  
APPELLATE BODY

**Brazil – Measures Affecting Imports of Retreaded Tyres**

European Communities, *Appellant*  
Brazil, *Appellee*

AB-2007-4

Present:

Abi-Saab, Presiding Member  
Baptista, Member  
Taniguchi, Member

Argentina, *Third Participant*  
Australia, *Third Participant*  
China, *Third Participant*  
Cuba, *Third Participant*  
Guatemala, *Third Participant*  
Japan, *Third Participant*  
Korea, *Third Participant*  
Mexico, *Third Participant*  
Paraguay, *Third Participant*  
Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu, *Third Participant*  
Thailand, *Third Participant*  
United States, *Third Participant*

**I. Introduction**

1. The European Communities appeals certain issues of law and legal interpretations developed in the Panel Report, *Brazil – Measures Affecting Imports of Retreaded Tyres* (the "Panel Report").<sup>1</sup> The Panel was established to consider a complaint by the European Communities concerning the consistency of certain measures imposed by Brazil on the importation and marketing of retreaded tyres<sup>2</sup> with the *General Agreement on Tariffs and Trade 1994* (the "GATT 1994").

<sup>1</sup>WT/DS332/R, 12 June 2007.

<sup>2</sup>Retreaded tyres are used tyres that are reconditioned for further use by stripping the worn tread from the skeleton (casing) and replacing it with new material in the form of a new tread, and sometimes with new material also covering parts or all of the sidewalls. (See Panel Report, para. 2.1) Retreaded tyres can be produced through different methods, all indistinctively referred to as "retreading". These methods are: (i) top-capping, which consists of replacing only the tread; (ii) re-capping, which entails replacing the tread and part of the sidewall; and (iii) remoulding, which consists of replacing the tread and the sidewall including all or part of the lower area of the tyre. (See *ibid.*, para. 2.2) The retreaded tyres covered in this dispute are classified under subheadings 4012.11 (motor cars), 4012.12 (buses and lorries), 4012.13 (aircraft), and 4012.19 (other types) of the *International Convention on the Harmonized Commodity Description and Coding System*, done at Brussels, 14 June 1983. In contrast, used tyres are classified under subheading 4012.20. New tyres are classified under heading 4011. (See *ibid.*, para. 2.4)

2. Before the Panel, the European Communities claimed that Brazil imposed a prohibition on the importation of retreaded tyres, notably by virtue of Article 40 of Portaria No. 14 of the Secretaria de Comércio Exterior ("SECEX") (Secretariat of Foreign Trade of the Brazilian Ministry of Development, Industry, and Foreign Trade), dated 17 November 2004 ("Portaria SECEX 14/2004")<sup>3</sup>, and that this prohibition was inconsistent with Article XI:1 of the GATT 1994.<sup>4</sup> The European Communities also contended that certain Brazilian measures providing for the imposition of fines on the importation of retreaded tyres, and on the marketing, transportation, storage, keeping, or warehousing of imported retreaded tyres<sup>5</sup>, were similarly inconsistent with Article XI:1 or, alternatively, Article III:4 of the GATT 1994.<sup>6</sup> In addition, the European Communities made claims under Article III:4 of the GATT 1994 in respect of certain state measures prohibiting the marketing of, and/or imposing disposal obligations on the importers of, imported retreaded tyres.<sup>7</sup> Finally, the European Communities challenged the exemption from the import prohibition on retreaded tyres and associated fines provided by Brazil to retreaded tyres originating in countries of the Mercado Común

<sup>3</sup>Exhibits BRA-84 and EC-29 submitted by Brazil and the European Communities, respectively, to the Panel. Article 40 of Portaria SECEX 14/2004 reads as follows:

Article 40 – An import license will not be granted for retreaded and used tires, whether as a consumer product or feedstock, classified under NCM code 4012, except for remoulded tires, classified under NCM codes 4012.11.00, 4012.12.00, 4012.13.00 and 4012.19.00, originating and proceeding from the MERCOSUR Member States under the Economic Complementation Agreement No. 18.

(See Panel Report, para. 2.7)

<sup>4</sup>*Ibid.*, paras. 3.1 and 7.1.

<sup>5</sup>Article 47-A of Presidential Decree 3.179 of 21 September 1999, as amended by Article 1 of Presidential Decree 3.919 of 14 September 2001, provides:

Importing used or recycled tires:

Fine of R\$ 400.00 (four hundred reais) per unit.

Sole paragraph: The same penalty shall apply to whosever trades, transports, stores, keeps or maintains in a depot a used or recycled tire imported under such conditions.

(*Ibid.*, para. 2.10 (referring to Exhibit BRA-72 submitted by Brazil to the Panel); see also Exhibit EC-34 submitted by the European Communities to the Panel)

<sup>6</sup>Panel Report, paras. 3.1 and 7.358.

<sup>7</sup>*Ibid.*, para. 7.391. The measures of the State of Rio Grande do Sul are identified in paragraphs 2.11 and 2.12 of the Panel Report.

del Sur ("MERCOSUR") (Southern Common Market).<sup>8</sup> The European Communities contended that these exemptions were inconsistent with Articles I:1 and XIII:1 of the GATT 1994.<sup>9</sup>

3. Brazil did not contest that the prohibition on the importation of retreaded tyres and associated fines were *prima facie* inconsistent with Article XI:1<sup>10</sup>; or that state measures prohibiting the marketing of, and/or imposing disposal obligations on the importers of, imported retreaded tyres were *prima facie* inconsistent with Article III:4<sup>11</sup>; or that the exemptions from both the import prohibition and associated fines afforded to retreaded tyres imported from MERCOSUR countries were *prima facie* inconsistent with Articles I:1 and XIII:1 of the GATT 1994.<sup>12</sup> Instead, Brazil submitted that the prohibition on the importation of retreaded tyres and associated fines, and state measures restricting the marketing of imported retreaded tyres, were all justified under Article XX(b) of the GATT 1994.<sup>13</sup> Brazil contended that the fines associated with the import prohibition on retreaded tyres were justified also under Article XX(d) of the GATT 1994.<sup>14</sup> Brazil further maintained that the exemption from the import prohibition and associated fines afforded to imports of *remoulded* tyres from MERCOSUR countries was justified under Articles XX(d) and XXIV of the GATT 1994.<sup>15</sup>

<sup>8</sup>The exemption from the import prohibition afforded to MERCOSUR countries is provided in Article 40 of Portaria SECEX 14/2004 (see *supra*, footnote 3) and applies exclusively to remoulded tyres, a subcategory of retreaded tyres. (See Panel Report, footnote 1440 to para. 7.265) The exemption from the fines associated with the import prohibition on retreaded tyres is provided in Article 1 of Presidential Decree 4.592 of 11 February 2003 (Exhibit BRA-79 submitted by Brazil to the Panel), and exempts imports of all categories of retreaded tyres originating in MERCOSUR countries from the fines provided in Article 47-A of Presidential Decree 3.179, as amended, in the following terms:

Article 1: Article 47-A of Decree 3.179 of 21 September 1999 shall apply with the addition of the following paragraph, and the current sole paragraph shall be renumbered as (1):

paragraph (2) – Imports of retreaded tyres classified under heading MCN 4012.1100, 4012.1200, 4012.1300 and 4012.1900, originating in the MERCOSUR member countries under Economic Complementarity Agreement No. 18 shall be exempt from payment of the fine referred to in this Article.

(See *supra*, footnote 5; see also Panel Report, para. 2.16)

<sup>9</sup>Panel Report, para. 7.448.

<sup>10</sup>*Ibid.*, paras. 7.2 and 7.359. Brazil did not acknowledge any inconsistency of the fines with Article III:4 of the GATT 1994. (See *ibid.*, para. 7.359)

<sup>11</sup>*Ibid.*, para. 7.392.

<sup>12</sup>*Ibid.*, para. 7.449.

<sup>13</sup>*Ibid.*, paras. 7.2, 7.217, 7.359, and 7.392.

<sup>14</sup>*Ibid.*, para. 7.359.

<sup>15</sup>*Ibid.*, para. 7.449.

4. The Panel Report was circulated to Members of the World Trade Organization (the "WTO") on 12 June 2007. The Panel found that the import prohibition on retreaded tyres was inconsistent with Article XI:1 and not justified under Article XX of the GATT 1994.<sup>16</sup> In its analysis, the Panel found that the import prohibition on retreaded tyres was provisionally justified as "necessary to protect human, animal or plant life or health" under Article XX(b).<sup>17</sup> However, the Panel also found that the importation of used tyres under court injunctions resulted in the import prohibition on retreaded tyres being applied by Brazil in a manner that constituted both "a means of unjustifiable discrimination [between countries] where the same conditions prevail"<sup>18</sup> and "a disguised restriction on international trade"<sup>19</sup>, within the meaning of the chapeau of Article XX of the GATT 1994.

5. The Panel found further that the fines associated with the import prohibition on retreaded tyres were inconsistent with Article XI:1 and not justified under either paragraph (b) or (d) of Article XX of the GATT 1994.<sup>20</sup> The Panel also determined that state law restrictions on the marketing of imported retreaded tyres and associated disposal obligations were inconsistent with Article III:4 and not justified under Article XX(b) of the GATT 1994.<sup>21</sup> The Panel exercised judicial economy with respect to the European Communities' claims that the exemption from the import prohibition and associated fines afforded to retreaded tyres imported from MERCOSUR countries was inconsistent with Articles I:1 and XIII:1 of the GATT 1994, and with respect to Brazil's related defence under Articles XX(d) and XXIV of the GATT 1994.<sup>22</sup> The Panel accordingly recommended that the Dispute Settlement Body (the "DSB") request Brazil to bring those measures found to be inconsistent into conformity with its obligations under the GATT 1994.<sup>23</sup>

6. At its meeting on 10 August 2007, the DSB agreed to a joint request by Brazil and the European Communities to extend the time period for adoption of the Panel Report until no later than 20 September 2007.<sup>24</sup> On 3 September 2007, the European Communities notified the DSB of its intention to appeal certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel, pursuant to Article 16.4 of the *Understanding on Rules and Procedures*

<sup>16</sup>Panel Report, paras. 7.357 and 8.1(a)(i) and (ii).

<sup>17</sup>*Ibid.*, para. 7.215.

<sup>18</sup>*Ibid.*, para. 7.310; see also para. 7.306.

<sup>19</sup>*Ibid.*, para. 7.349.

<sup>20</sup>*Ibid.*, para. 8.1(b). The Panel did not rule on the European Communities' alternative claim that the fines associated with the prohibition on the importation of retreaded tyres were inconsistent with Article III:4 of the GATT 1994. (See *ibid.*, para. 7.364)

<sup>21</sup>*Ibid.*, para. 8.1(c).

<sup>22</sup>*Ibid.*, paras. 7.456 and 8.2.

<sup>23</sup>*Ibid.*, para. 8.4.

<sup>24</sup>WT/DS332/8, 31 July 2007. The minutes of the DSB meeting are set out in WT/DSB/M/237.

*Governing the Settlement of Disputes* (the "DSU"), and filed a Notice of Appeal<sup>25</sup> pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "*Working Procedures*").<sup>26</sup> On 10 September 2007, the European Communities filed an appellant's submission.<sup>27</sup> On 28 September 2007, Brazil filed an appellee's submission.<sup>28</sup> On the same day, Argentina, Australia, Japan, Korea, the Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu, and the United States each filed a third participant's submission.<sup>29</sup> Also on 28 September 2007, China, Cuba, Guatemala, Mexico, and Thailand each notified its intention to appear at the oral hearing as a third participant.<sup>30</sup> On 5 October 2007, Paraguay notified its intention to appear at the oral hearing as a third participant.<sup>31</sup>

7. On 28 September 2007, the Appellate Body received an *amicus curiae* brief from the Humane Society International. On 11 October 2007, the Appellate Body further received an *amicus curiae* brief submitted jointly by a group of nine non-governmental organizations.<sup>32</sup> The Appellate Body Division hearing the appeal did not find it necessary to take these *amicus curiae* briefs into account in rendering its decision.

8. The oral hearing in this appeal was held on 15 and 16 October 2007. The participants and the third participants, with the exception of Argentina, China, Guatemala, Mexico, Paraguay, and Thailand, made oral statements. The participants and the third participants responded to questions posed by the Members of the Division hearing the appeal.

<sup>25</sup>WT/DS332/9, 3 September 2007 (attached as Annex I to this Report).

<sup>26</sup>WT/AB/WP/5, 4 January 2005.

<sup>27</sup>Pursuant to Rule 21 of the *Working Procedures*.

<sup>28</sup>Pursuant to Rule 22 of the *Working Procedures*.

<sup>29</sup>Pursuant to Rule 24(1) of the *Working Procedures*.

<sup>30</sup>Pursuant to Rule 24(2) of the *Working Procedures*.

<sup>31</sup>Pursuant to Rule 24(4) of the *Working Procedures*.

<sup>32</sup>These non-governmental organizations are: Associação de Combate aos Poluentes (ACPO), Brazil; Associação de Proteção ao Meio Ambiente de Cianorte (APROMAC), Brazil; Centro de Derechos Humanos y Ambiente (CEDHA), Argentina; Center for International Environmental Law (CIEL), United States and Switzerland; Conectas Direitos Humanos, Brazil; Friends of the Earth Europe, Belgium; The German NGO Forum on Environment and Development, Germany; Justiça Global, Brazil; and Instituto O Direito por Um Planeta Verde, Brazil.

## II. Arguments of the Participants and the Third Participants

### A. *Claims of Error by the European Communities – Appellant*

#### I. The Necessity Analysis

9. The European Communities claims that the Panel erred in finding that the import prohibition on retreaded tyres imposed by Brazil (the "Import Ban") was necessary to protect human, animal, or plant life or health, within the meaning of Article XX(b) of the GATT 1994. The European Communities requests the Appellate Body to reverse this finding and to find, instead, that the Import Ban is not "necessary" within the meaning of Article XX(b).

10. The European Communities' claims of error are directed at three distinct aspects of the Panel's necessity analysis: first, the Panel's finding that the Import Ban contributed to the realization of its stated objective; secondly, the Panel's finding that there were no reasonably available alternatives to the Import Ban; and thirdly, the Panel's alleged failure to conduct the process of weighing and balancing the relevant factors and the alternatives that was required to determine whether the Import Ban was "necessary" under Article XX(b). The arguments advanced by the European Communities in relation to each of these claims of error are addressed in turn.

#### (a) The Contribution Analysis

11. The European Communities argues that the Panel erred in finding that the Import Ban contributed to the protection of human, animal, or plant life or health. The European Communities maintains that the Panel "applied an erroneous legal standard"<sup>33</sup> by examining whether the Import Ban could make, or *could have made*, a contribution to the protection of human life or health, rather than establishing the *actual* contribution of the measure to its objective. By applying a standard of potential contribution, rather than one of actual contribution, the Panel acted inconsistently with the case law of the Appellate Body<sup>34</sup>, which requires the Panel to have assessed the extent of the contribution made by the Import Ban to the reduction of waste tyres arising in Brazil. The European Communities reasons that "no meaningful weighing and balancing is possible"<sup>35</sup> absent a proper determination of the extent of the contribution made by the measure, and that, for necessity to be demonstrated, the contribution required is "more than mere suitability", it must be "verifiable and significant".<sup>36</sup> In this case, assessing the contribution of the measure to the achievement of its stated

<sup>33</sup>European Communities' appellant's submission, para. 166.

<sup>34</sup>*Ibid.*, para. 169 (referring to Appellate Body Report, *Korea – Various Measures on Beef*, para. 164).

<sup>35</sup>*Ibid.*, para. 171.

<sup>36</sup>*Ibid.*, para. 172.

goals involved assessing whether the Import Ban reduced the number of waste tyres in Brazil. The European Communities does not see how this could have been done in any way *other than* through quantification, and stresses that this is *not* a case involving scientific uncertainty about the existence of risks. Rather, that "[t]he very indirect nature of the alleged risks attributed to imported retreaded tyres should have called for a particularly diligent examination of the contribution made by the ban to the reduction of the number of waste tyres arising in Brazil."<sup>37</sup>

12. In addition, the European Communities claims that the Panel did not make an objective assessment of the facts of the case, as required by Article 11 of the DSU, in determining the contribution of the Import Ban to the realization of the ends pursued by it. The European Communities asserts that the Panel ignored significant facts and arguments in its analysis, and failed to conduct an overall assessment of the evidence, instead, referring to the evidence before it in a selective and distorted manner.

13. According to the European Communities, in concluding that it had "no reason to believe that new tyres sold in Brazil are low-quality tyres"<sup>38</sup> that were not capable of being retreaded, the Panel ignored evidence that demonstrated "the existence ... of low-quality non-retreadable tyres"<sup>39</sup> in Brazil. The Panel's finding that "at least some domestic used tyres are being retreaded in Brazil"<sup>40</sup> is based exclusively on a statement contained in a report by the Associação Brasileira do Segmento de Reforma de Pneus (the "ABR") (Brazilian Association of the Retreading Industry) (the "ABR Report")<sup>41</sup> and on Technical Note 001/2006 of the Instituto Nacional de Metrologia, Normalização e Qualidade Industrial ("INMETRO") (National Institute for Metrology, Standardization and Industrial Quality).<sup>42</sup> The European Communities submits that the Panel failed to consider that the former is directly contradicted by a second report by the ABR<sup>43</sup>, or to discount the evidentiary value of the

<sup>37</sup>European Communities' appellant's submission, para. 177. For the European Communities, the indirect nature of the alleged risk distinguishes this case from *EC – Asbestos*, as the factual context of this case does not concern the evaluation of risk in quantitative or qualitative terms. Rather, it concerns the quantification of the contribution of the measure to achieving its stated objective. (See *ibid.*, para. 175)

<sup>38</sup>*Ibid.*, para. 183 (quoting Panel Report, para. 7.137).

<sup>39</sup>*Ibid.* (referring to Exhibits EC-15 and EC-67 to EC-71 submitted by the European Communities to the Panel); European Communities' oral statement at the first Panel meeting, para. 28; and European Communities' response to Question 11 posed by the Panel, Panel Report, pp. 254-255).

<sup>40</sup>Panel Report, para. 7.136.

<sup>41</sup>European Communities' appellant's submission, para. 186 (referring to the report of the ABR on tyre retreading activities in Brazil, 26 May 2006 (Exhibit BRA-95 submitted by Brazil to the Panel), para. 6).

<sup>42</sup>Exhibit BRA-163 submitted by Brazil to the Panel.

<sup>43</sup>European Communities' appellant's submission, para. 187 (referring to the report of the ABR on the reformed tyres sector in Brazil, 23 June 2006 (Exhibit BRA-157 submitted by Brazil to the Panel), para. 6).

latter given that it was issued during the course of the Panel proceedings and contradicts the earlier INMETRO Technical Note 83/2000.<sup>44</sup>

14. Moreover, the European Communities contends that the Panel ignored evidence that contradicted its findings regarding the retreadability of used tyres in Brazil, namely, a study by the consultancy LAFIS<sup>45</sup>, and the fact that domestic retreaders have sought court injunctions to obtain the right to import used tyres for further retreading in Brazil. The European Communities also denounces the Panel's references to measures that Brazil might adopt in the future (such as more frequent automotive inspections), emphasizing that the question of whether the Import Ban contributed to the achievement of its stated objective had to be determined at the time of the establishment of the Panel, and speculation about future events is not a sufficient basis for an objective assessment of the facts.

(b) Alternatives to the Import Ban

15. The European Communities argues that the Panel committed multiple errors in holding that there were no reasonably available alternatives to the Import Ban that would ensure the same level of protection of human life and health. The European Communities points out that it presented two categories of alternative measures: measures to reduce the *accumulation* of waste tyres; and measures to improve the *management* of waste tyres.

16. In the view of the European Communities, the Panel improperly excluded measures to ensure a better implementation and enforcement of the import ban on *used* tyres from its analysis of possible alternatives to the Import Ban on *retreaded* tyres. The most relevant and obvious alternative that would allow Brazil to prevent the risks associated with the accumulation of waste tyres would be to put an end to the importation of used tyres. Thus, the European Communities insists, the Panel should have analyzed this alternative irrespective of whether it also considered the implementation of the import ban on used tyres as part of its analysis under the chapeau of Article XX.

17. The European Communities adds that the Panel incorrectly defined as "alternatives" to the Import Ban only measures that avoid the generation of waste tyres specifically from imported retreaded tyres. Such a narrow definition of "alternatives" wrongly links the notion of alternative measures to the *means* (avoidance or non-generation of waste tyres) employed by the measure at issue

<sup>44</sup>European Communities' appellant's submission, paras. 188 and 189; Exhibit EC-45 submitted by the European Communities to the Panel.

<sup>45</sup>*Ibid.*, para. 190 (referring to the report by LAFIS, "Auto Parts and Vehicles: Tyres", 20 April 2006 (Exhibit EC-92 submitted by the European Communities to the Panel), p. 11). This study indicates that, in Brazil, the overall rate of retreading for all types of vehicles is 9.9 per cent.

to achieve its objective, rather than to the objective itself. Available alternatives to the Import Ban are not, therefore, as the Panel found, limited to non-generation measures, but include any alternatives that would allow Brazil to attain the stated objective of the Import Ban, namely, the protection of life and health from mosquito-borne diseases and from tyre fire emissions. In the European Communities' view, the Panel's narrow conception of "alternative" resulted in the erroneous rejection of several alternatives that were capable of achieving this objective, such as measures to improve the domestic retreading and retreadability of tyres, the collection and disposal scheme imposed by the Conselho Nacional do Meio Ambiente ("CONAMA") (National Council for the Environment of the Ministry of the Environment), and measures relating to the management of waste tyres, such as co-incineration.

18. The European Communities points to two additional errors in the Panel's conception of alternative measures. First, the Panel refused to consider as alternatives measures that could be "cumulative rather than substitutable"<sup>46</sup> with the Import Ban. For the European Communities, a measure that is cumulative or complementary to the Import Ban is capable of achieving the same objective as the ban and, therefore, is an alternative that must be taken into account. Secondly, in examining the CONAMA scheme and co-incineration of waste tyres, the Panel did not inquire whether the proposed options exist and are reasonably available, but, instead, examined whether those options are actually being employed.

19. Moreover, the European Communities argues that the Panel erred by excluding as alternatives a correct and complete implementation of certain state measures merely on the basis that these measures have already been implemented in Brazil. Specifically, the European Communities submits that evidence before the Panel demonstrated that Brazil neither implements correctly the obligations under the CONAMA scheme, nor enforces properly its collection and disposal system. Therefore, a better enforcement of the CONAMA scheme is an alternative that would be more effective than the Import Ban in reducing risks associated with tyre waste. The Panel also erroneously ignored the European Communities' contention that collection and disposal programmes, such as Paraná Rodando Limpo<sup>47</sup> should be adopted by all states in Brazil.

20. The European Communities also challenges the Panel's findings that most of the material recycling alternatives it proposed could not constitute reasonably available alternatives to the Import Ban because they "are only capable of disposing [of] a small ... number of waste tyres".<sup>48</sup> The case law of the Appellate Body regarding Article XX(b) does not require that one single alternative

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<sup>46</sup>European Communities' appellant's submission, para. 225 (quoting Panel Report, para. 7.169).

<sup>47</sup>See Exhibit EC-49 submitted by the European Communities to the Panel.

<sup>48</sup>European Communities' appellant's submission, para. 238 (referring to Panel Report, paras. 7.201, 7.205, and 7.206). (underlining omitted)

measure achieve the same objective as the challenged measure. Therefore, the Panel erred in rejecting several alternative measures on the grounds that, taken individually, each measure did not fully attain the objective of the challenged measure. The European Communities also considers that the Panel erred in its analysis by requiring alternatives to be capable of dealing with the management of *all* waste tyres in Brazil, rather than with the number of waste tyres attributable to imported *retreaded* tyres.

21. Finally, the European Communities submits that the Panel's factual findings regarding reasonably available alternatives were not based on an objective assessment of the facts, as required by Article 11 of the DSU. More specifically, the Panel's rejection of landfilling of waste tyres as an alternative to the Import Ban was based on evidence related exclusively to landfilling of *whole* tyres, when the only alternative proposed was the landfilling of *shredded* tyres, and the Panel did not take into account legislation that permits the landfilling of shredded tyres in Brazil. As regards controlled stockpiling, the Panel erred in rejecting this alternative on the grounds that stockpiling does not dispose of waste tyres, and that it entails some risk to human health and the environment. As recognized in the *Basel Convention on the Control of Transboundary Movements of Hazardous Waste and Their Disposal*<sup>49</sup>, controlled stockpiling is a disposal operation that is used for temporary storage. It is a crucial element in managing waste tyres, and the mere fact that it does not avoid *all* the risks that the Import Ban seeks to eliminate does not mean that it could not be an alternative. Regarding co-incineration, the European Communities argues that the Panel relied on evidence on co-incineration activities in countries other than Brazil<sup>50</sup>, and failed to require Brazil to explain why unused capacity in its existing incineration facilities could not be used to burn more waste tyres as an available alternative to the Import Ban. The European Communities adds that the Panel's finding that co-incineration "may potentially pose health risks to humans"<sup>51</sup> is based on outdated evidence that does not represent the current state of the art on energy recovery.

22. The European Communities contends further that the Panel's rejection of material recycling as an alternative to the Import Ban is also not based on an objective assessment of the facts. The Panel disregarded evidence presented by the European Communities and, instead, relied on a brief paper by an unidentified organization, which related to a single material recycling application—civil engineering—to conclude that "it is not clear that these [material recycling] applications are entirely

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<sup>49</sup>Adopted 1989; entry into force 1992 (Exhibit EC-24 submitted by the European Communities to the Panel).

<sup>50</sup>European countries and the United States. See also Panel Report, footnote 1339 to para. 7.192.

<sup>51</sup>European Communities' appellant's submission, para. 262 (quoting Panel Report, para. 7.192).

safe".<sup>52</sup> The European Communities adds that the Panel's conclusion that material recycling alternatives, such as civil engineering and rubber asphalt, would not be "reasonably" available due to their prohibitive costs was based on evidence adduced exclusively in relation to a single material recycling application—devulcanization.

23. Finally, the European Communities claims that the Panel failed to analyze one of the possible alternative measures identified by the European Communities, and which has already been adopted by Brazil—the National Dengue Control Programme<sup>53</sup>—and that this failure constitutes a violation of Article 11 of the DSU.

(c) The Weighing and Balancing Process

24. The European Communities claims that the Panel failed to conduct the process of weighing and balancing the relevant factors and the alternatives that was required in order to determine whether the Import Ban was "necessary" under Article XX(b) of the GATT 1994. For the European Communities, weighing and balancing involves, first, an individual assessment of each element (importance of the objective pursued; trade restrictiveness of the measure; contribution of the measure to the achievement of the objective) and, then, a consideration of the role and relative importance of each element together with the other elements, for the purposes of deciding whether the challenged measure is necessary to achieve the relevant objective. The Panel, however, failed to weigh properly the trade restrictiveness of the Import Ban. Because the Panel incorrectly analyzed the extent of the contribution of the Import Ban to the reduction in the number of waste tyres and, indirectly, to the protection of human life and health, the Panel was also incapable of properly weighing and balancing this contribution against any of the other elements. The Panel failed to consider that the risks addressed by the Import Ban were not directly linked to retreaded tyres but to the waste they eventually turn into, and that the level of such risks depends on how waste tyres are managed and disposed of. Thus, the Panel failed to acknowledge the indirect, uncertain, and relative contribution of the Import Ban to its stated objective and, in turn, failed to limit the weight afforded to this element in the weighing and balancing process.

<sup>52</sup>European Communities' appellant's submission, para. 274 (referring to Panel Report, para. 7.208). The European Communities also criticizes the Panel for reaching its finding on high costs of rubber asphalt applications on the basis of a piece of evidence describing this application as a "promising outlet for recycled rubber because rubberised asphalt lasts longer than conventional asphalt". (*Ibid.*, para. 279 (quoting Panel Report, footnote 1367 to para. 7.205, in turn quoting the report of the Organisation for Economic Co-operation and Development ("OECD"), Working Group on Waste Prevention and Recycling, ENV/EPOC/WGWPR(2005)3/FINAL, 26 September 2005 (Exhibit EC-16 submitted by the European Communities to the Panel)))

<sup>53</sup>Brazil's Ministry of Health National Dengue Control Programme (NDCP), adopted 24 July 2002 (Exhibit EC-93 submitted by the European Communities to the Panel).

25. The European Communities contends that the Panel based its weighing and balancing exercise on its flawed analysis of reasonably available alternatives. The Panel also failed to take proper account of the trade restrictiveness of the Import Ban in the weighing and balancing exercise. The Panel focused on non-generation measures, and overlooked the considerable advantages of sound waste tyre collection and disposal schemes, including the fact that the implementation of the CONAMA scheme is less trade restrictive than the Import Ban. The Panel conducted an individual analysis of possible alternatives, did not really carry out a global assessment, and discarded measures that have already been implemented without verifying the extent of implementation. In sum, asserts the European Communities, the Panel did not conduct a proper weighing and balancing of the relevant elements and alternatives, but, rather, a superficial analysis that repeated all of the errors it had already made in its assessment of the necessity of the Import Ban.

26. For all of the above reasons, the European Communities requests the Appellate Body to reverse the Panel's finding that the Import Ban was "necessary" to protect human, animal, or plant life or health, within the meaning of Article XX(b) of the GATT 1994. Should the Appellate Body accept this request, the European Communities further requests the Appellate Body to find that the Import Ban is not "necessary" within the meaning of Article XX(b) of the GATT 1994.

2. The Chapeau of Article XX of the GATT 1994

(a) The MERCOSUR Exemption

27. The European Communities claims that the Panel erred in finding that the exemption from the Import Ban on imports of retreaded tyres from MERCOSUR countries (the "MERCOSUR exemption") did not constitute arbitrary or unjustifiable discrimination or a disguised restriction on international trade and was not, therefore, contrary to the chapeau of Article XX of the GATT 1994. These findings were based on a "confused" analysis "marred by serious errors of law".<sup>54</sup> In particular, the European Communities emphasizes that the fact that Brazil introduced the MERCOSUR exemption in order to comply with its obligations under MERCOSUR does not preclude a finding of "arbitrary" discrimination. The European Communities argues further that the volume of imports from MERCOSUR countries is irrelevant to the analysis of whether that exemption constitutes arbitrary or unjustifiable discrimination. The European Communities requests the Appellate Body to reverse this finding and to find, instead, that the MERCOSUR exemption results in the Import Ban being applied inconsistently with the chapeau of Article XX.

<sup>54</sup>European Communities' appellant's submission, para. 304.

28. For the European Communities, the "arbitrary" discrimination and the "unjustifiable" discrimination mentioned in the chapeau of Article XX are closely related. Both require discrimination to be explained through convincing, reasonable, and rational arguments. What is arbitrary and unjustifiable discrimination must, in the view of the European Communities, be established in relation to the objective of the measure at issue and the conditions prevailing in the countries concerned. At the same time, the notions of "arbitrary" and "unjustifiable" are not identical: "the term 'arbitrary' has its 'centre of gravity' in the lack of consistency and predictability in the application of the measure, while the term 'unjustifiable' refers more to the lack of motivation and capacity to convince."<sup>55</sup>

29. The European Communities submits that, in its analysis, the Panel wrongly defined "arbitrary" discrimination as being limited to "capricious", "unpredictable", or "random" discrimination.<sup>56</sup> This definition failed to take into account the object and purpose of Article XX, as well as the context provided by the close link between "arbitrary discrimination" and "unjustifiable discrimination". The European Communities adds that this definition would deprive arbitrary discrimination of its useful value, because "few actions of governments are ever entirely 'random' or 'capricious'."<sup>57</sup> The chapeau of Article XX expresses "requirements of good faith, and requires a delicate balancing of the interests of the Member invoking an exception ... and the rights of other Members".<sup>58</sup> The European Communities contends that the Panel's approach, however, was not consistent with the required balancing of interests, because it would allow discrimination "on the basis of purely extraneous factors which have nothing to do with the objectives of the measure"<sup>59</sup>, as long as the discrimination is not random or capricious.

30. According to the European Communities, whether a measure involves arbitrary discrimination can only be determined by taking into account the objective of the measure in respect of which Article XX is invoked. A measure will not be arbitrary if it "appears as reasonable, predictable and foreseeable"<sup>60</sup> in the light of that objective.

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<sup>55</sup>European Communities' appellant's submission, para. 310 (referring to European Communities' first written submission to the Panel, para. 152).

<sup>56</sup>Panel Report, paras. 7.272, 7.280, and 7.281.

<sup>57</sup>European Communities' appellant's submission, para. 316.

<sup>58</sup>*Ibid.*, para. 319 (referring to Appellate Body Report, *US – Shrimp*, paras. 158 and 159, where the Appellate Body also found that the "rigidity" and "inflexibility" of certain certification requirements introduced by the United States constituted "arbitrary discrimination").

<sup>59</sup>*Ibid.*, para. 319.

<sup>60</sup>*Ibid.*, para. 321.

31. It follows, according to the European Communities, that the Panel erred in finding that the MERCOSUR exemption did not constitute arbitrary discrimination because it had been introduced in response to a ruling of a MERCOSUR arbitral tribunal. The MERCOSUR exemption does not further, and has the potential of undermining, the stated objective of the measure (the protection of life and health from risks arising from mosquito-borne diseases and tyre fires), and for this reason must be regarded as unreasonable, contradictory, and thus arbitrary. For the European Communities, allowing a Member's obligations under other international agreements to render discrimination consistent with the chapeau of Article XX would seriously undermine the effectiveness of the chapeau. The fact that the chapeau of Article XX prohibits discrimination "between countries where the same conditions prevail" provides further support for the European Communities' interpretation, because whether the same conditions prevail in different countries is an objective question, not a question of legal obligations *vis-à-vis* another country. It is thus "inconceivable that the mere compliance with an international agreement would suffice to render discrimination between countries where the same conditions prevail compatible with the chapeau of Article XX".<sup>61</sup>

32. As regards the Panel's attempt to buttress its reasoning by referring to Article XXIV of the GATT 1994 and the "nature" of Mercosur as an agreement<sup>62</sup> within the meaning of that provision, the European Communities submits that agreements justified under Article XXIV would not entitle Members to discriminate in the application of Article XX measures, because Article XXIV:8(a)(i) and (b) explicitly excludes measures that are justified under Article XX from the requirement to eliminate restrictive regulations of commerce with respect to substantially all the trade within a customs union or free trade area. The European Communities further criticizes the Panel for not verifying whether MERCOSUR is a customs union that complies with the requirements of Article XXIV of the GATT 1994.

33. The European Communities points to two additional flaws in the Panel's reasoning: its statement that it took into account "the nature of the ruling on the basis of which Brazil has acted"<sup>63</sup>, and the Panel's reliance on Brazil's statement that the MERCOSUR exemption was "the only course of action available to it"<sup>64</sup> to implement the ruling. The nature of the ruling on the basis of which Brazil has acted is irrelevant for the determination of whether the MERCOSUR exemption constitutes arbitrary discrimination. Moreover, before the MERCOSUR tribunal, Brazil chose not to defend the Import Ban by invoking an exception clause related to the protection of human life and health, and

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<sup>61</sup>European Communities' appellant's submission, para. 325.

<sup>62</sup>*Ibid.*, para. 329.

<sup>63</sup>*Ibid.*, para. 330 (referring to Panel Report, para. 7.283).

<sup>64</sup>*Ibid.*, para. 332 (referring to Panel Report, para. 7.280).

thus the fact that it invoked such grounds in this dispute must be regarded as arbitrary. The European Communities further submits that the MERCOSUR tribunal did not oblige Brazil to discriminate between its MERCOSUR partners and other WTO Members, because Brazil could have implemented the arbitral ruling by lifting the Import Ban with respect to all third countries.

34. The European Communities argues further that the Panel erred in finding that unjustifiable discrimination could arise only if imports under the MERCOSUR exemption were to take place in such amounts that the achievement of the objective of the Import Ban would be significantly undermined. By assessing the existence of unjustifiable discrimination on the basis of import volumes, the Panel applied a test that has no basis in the text of Article XX and finds no support in WTO case law. The European Communities adds that, if adopted by the DSB, this finding would diminish its rights under the covered agreements, contrary to Article 3.2 of the DSU.

35. The European Communities submits that import volumes under the MERCOSUR exemption are irrelevant for determining whether this exemption constitutes arbitrary or unjustifiable discrimination. The specific volume of imports from MERCOSUR countries in a given year is not related to the manner in which the Import Ban is applied, but rather dependent upon economic factors relating to supply and demand. Moreover, this volume can fluctuate significantly from year to year, and may be more likely to do so if the Panel's finding stands, given that it creates an incentive to shift retreaded tyre production to MERCOSUR countries, especially to those that do not restrict the importation of used tyres. Thus, reasons the European Communities, in addition to being incorrect, the Panel's findings increase the likelihood of future litigation on whether increases in imports from MERCOSUR countries have rendered the exemption inconsistent with the chapeau. This is not consistent with Article 3.3 of the DSU, which provides that the prompt settlement of disputes "is essential for the effective functioning of the WTO".<sup>65</sup>

36. According to the European Communities, the Panel's approach is also inconsistent with the Appellate Body Report in *US – Gambling*, where "the Appellate Body did not attach importance to the 'volume' of services traded under [that] exemption, and to how that volume compared with the volume of online gambling services offered by Antigua and Barbuda or, in fact, all other WTO Members cumulatively."<sup>66</sup> The Panel's approach also goes against Appellate Body reports confirming the right of Members to challenge measures, *as such*, and the need to protect the security and predictability of the multilateral trading system that underpins that right.<sup>67</sup> Yet, under the Panel's

<sup>65</sup>European Communities' appellant's submission, para. 343.

<sup>66</sup>*Ibid.*, para. 344 (referring to Appellate Body Report, *US – Gambling*, para. 369).

<sup>67</sup>*Ibid.*, para. 345 (referring to Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review*, para. 82).

approach, the question of which volumes of imports would be regarded as "significant" for purposes of the chapeau of Article XX would ultimately depend on market factors, and could be assessed only *ex post* based on data relating to trade flows.

37. The European Communities also contests the Panel's conclusions that the MERCOSUR exemption did not constitute "a disguised restriction on international trade" within the meaning of the chapeau of Article XX. Like its finding on unjustifiable discrimination, the Panel's finding was based on the rationale that MERCOSUR imports have not been significant in volume. Thus, submits the European Communities, the Panel's finding on a disguised restriction on international trade is equally erroneous. The European Communities fails to understand how the Panel could characterize the imports under the MERCOSUR exemption, increasing tenfold since 2002 from 200 to 2,000 tons of tyres per year by 2004, as "insignificant".<sup>68</sup>

38. For these reasons, the European Communities requests the Appellate Body to reverse the Panel's finding that the MERCOSUR exemption did not constitute arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, within the meaning of the chapeau of Article XX, and to find, instead, that the MERCOSUR exemption results in the Import Ban being applied inconsistently with the requirements of that provision.

(b) Imports of Used Tyres

39. With respect to the Panel's analysis of imports of used tyres under the chapeau of Article XX, the European Communities supports the Panel's conclusion that such imports constituted unjustifiable discrimination between countries where the same conditions prevail, but challenges several other findings made by the Panel in this part of its analysis. Specifically, the European Communities contends that the Panel erred, first, in finding that the imports of used tyres through court injunctions did not result in arbitrary discrimination and, secondly, in finding that such imports constituted unjustifiable discrimination and a disguised restriction on international trade only to the extent that they occurred in such amounts as to significantly undermine the objective of the Import Ban.

40. For the European Communities, the Panel adopted an overly restrictive approach to the notion of "arbitrary discrimination", in considering that action is not arbitrary as long as there is some cause or reason to explain it. What is arbitrary must be decided in the light of the stated objective of the measure. The European Communities reasons that, because, from the perspective of the protection of human life or health, there is no difference between, on the one hand, a retreaded tyre produced in the

<sup>68</sup>European Communities' appellant's submission, para. 348.

European Communities and, on the other hand, a retreaded tyre produced in Brazil from a casing imported from the European Communities, the importation of used tyres through court injunctions must be regarded as constituting arbitrary discrimination. The European Communities adds that the Panel's attempt to distinguish between, on the one hand, the actions of Brazilian courts in granting injunctions allowing imports of used tyres and, on the other hand, the compliance of administrative authorities with those injunctions, is ill-founded. A WTO Member must assume responsibility for the acts of all the branches of its government. The contradiction between the actions of the branches of the Brazilian government that have allowed the importation of used tyres, and those that ban the importation of retreaded tyres, must be regarded as arbitrary behaviour on the part of Brazil.

41. The European Communities also submits that the Panel erred in finding that the imports of used tyres under court injunctions resulted in unjustifiable discrimination only to the extent that they significantly undermined the objective of the Import Ban. In analyzing whether imports of used tyres under court injunctions were inconsistent with the chapeau of Article XX, the Panel applied the same quantitative approach that it had incorrectly applied when assessing the MERCOSUR exemption under that provision. The European Communities refers to the arguments it advanced in relation to the MERCOSUR exemption to explain why the volumes of imports are irrelevant for purposes of determining the consistency of a measure with the chapeau of Article XX.

42. The European Communities observes further that the court injunctions effectively exempt Brazilian retreaders from the import ban on used tyres, because they do not contain any temporal or quantitative limitations. Thus, the Panel's quantitative approach engenders uncertainty for the implementation of the Panel Report and is not in accordance with the prompt settlement of the dispute as required by Article 3.3 of the DSU. The Panel characterized imports of 10.5 million used tyres into Brazil in 2005 as "significant", but failed to identify the threshold below which imports of used tyres would no longer be "significant". The European Communities adds that, for the same reasons adduced in relation to unjustifiable discrimination, the Panel erred in finding that the imports of used tyres through court injunctions resulted in the Import Ban being applied in a manner that constitutes a disguised restriction on international trade only to the extent that these imports occurred in such quantities that they significantly undermined the objective of the Import Ban.

43. For all these reasons, the European Communities requests the Appellate Body to reverse the Panel's finding that imports of used tyres under court injunctions did not constitute arbitrary discrimination under the chapeau of Article XX, and constituted unjustifiable discrimination or a disguised restriction on international trade under the terms of this provision only to the extent that those imports significantly undermined the objective of the Import Ban. The European Communities requests the Appellate Body to find, instead, that imports of used tyres under court injunctions result

in the Import Ban being applied inconsistently with all of the requirements of the chapeau of Article XX of the GATT 1994.

### 3. Conditional Appeal

44. Should the Appellate Body not find, as requested by the European Communities, that the MERCOSUR exemption results in the Import Ban being applied inconsistently with the chapeau of Article XX, then the European Communities conditionally appeals the Panel's decision to exercise judicial economy with respect to its separate claims that the MERCOSUR exemption is inconsistent with Articles I:1 and XIII:1 of the GATT 1994. In such circumstances, the European Communities requests the Appellate Body to reverse the Panel's decision to exercise judicial economy with respect to these claims and to complete the legal analysis and find that the MERCOSUR exemption is inconsistent with Articles I:1 and XIII:1, and not justified under Articles XX(d) and XXIV of the GATT 1994.

#### (a) The Panel's Exercise of Judicial Economy

45. The European Communities submits that, in declining to rule on the European Communities' claims under Articles I.1 and XIII:1 of the GATT 1994, the Panel exercised "false judicial economy" and did not provide a positive resolution to the dispute as required by Articles 3.3, 3.4, and 3.7 of the DSU.<sup>69</sup> In the light of the Panel's finding that the Import Ban was inconsistent with the chapeau of Article XX only to the extent that imports of used tyres were occurring in amounts that significantly undermined the objective of the Import Ban, Brazil was under no obligation to remove the MERCOSUR exemption *per se*. Therefore, the Panel should have addressed the European Communities' claims that the MERCOSUR exemption *per se* is incompatible with Articles I:1 and XIII:1.

#### (b) Completing the Legal Analysis

46. The European Communities submits that there are sufficient factual findings of the Panel and untested facts on record for the Appellate Body to complete the legal analysis and find that the MERCOSUR exemption is incompatible with Articles I:1 and XIII:1, and is not justified under Articles XX(d) and XXIV of the GATT 1994. The European Communities recalls that Brazil did not contest that the MERCOSUR exemption constitutes a violation of Articles I:1 and XIII:1. Therefore, the only question to be addressed by the Appellate Body is whether this measure can be justified under Articles XX(d) and XXIV.

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<sup>69</sup>European Communities' appellant's submission, para. 375.

(c) The MERCOSUR Exemption and Article XXIV of the GATT 1994

47. The European Communities argues that the MERCOSUR exemption is not justified under Article XXIV of the GATT 1994, because it does not satisfy the two conditions identified by the Appellate Body in its Report in *Turkey – Textiles*.<sup>70</sup> First, Brazil failed to demonstrate that MERCOSUR complies with the conditions of Article XXIV:8(a) and 5(a) of the GATT 1994. As explained extensively in the European Communities' submissions to the Panel, Brazil failed to demonstrate that MERCOSUR has achieved a liberalization of "substantially all"<sup>71</sup> the trade within MERCOSUR, as required by Article XXIV:8(a)(i). The European Communities contends that trade in the automotive and sugar sectors has not been entirely liberalized within MERCOSUR, and highlights that "the automotive sector alone accounts for approximately 29%"<sup>72</sup> of trade within MERCOSUR. In addition, according to the European Communities, exceptions to MERCOSUR's common external tariff "currently concern up to 10% of the tariff lines"<sup>73</sup> applicable to external trade, and individual MERCOSUR countries "maintain export duties and 'other regulations of commerce' on trade with third countries that are not common to all Mercosur countries."<sup>74</sup>

48. The European Communities adds that Brazil failed to demonstrate that MERCOSUR complies with the requirement in Article XXIV:5(a) of the GATT 1994 that duties and other restrictive regulations of commerce are not to be on the whole more restrictive than the general incidence of these measures prior to the creation of MERCOSUR, in particular, as regards non-tariff measures. Indeed, emphasizes the European Communities, the measure at issue in this dispute illustrates that MERCOSUR countries continue to adopt such non-tariff measures.

49. Secondly, the European Communities maintains that Brazil has not shown that the MERCOSUR exemption was necessary for the formation of MERCOSUR. Nothing in the reasoning of the Appellate Body Report in *Turkey – Textiles* suggests that this condition would not apply to cases such as this one where a restriction is first imposed on all goods, and then subsequently removed only for goods originating in the customs union. Moreover, the European Communities considers that "Article XXIV would be turned into an almost limitless exception, which would allow

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<sup>70</sup>European Communities' appellant's submission, para. 381 (referring to Appellate Body Report, *Turkey – Textiles*, para. 58).

<sup>71</sup>*Ibid.*, para. 383.

<sup>72</sup>*Ibid.*

<sup>73</sup>*Ibid.*, para. 384 (referring to Committee on Trade and Development, "Examination of the Southern Common Market (MERCOSUR) Agreement", WT/COMTD/1/Add.17, 9 June 2006 (Exhibit EC-121 submitted by the European Communities to the Panel), p. 2).

<sup>74</sup>*Ibid.*

parties to a customs union to take any measure derogating from WTO obligations"<sup>75</sup> if WTO Members were not required to demonstrate that the measure was necessary for the formation of the customs union in question.

50. The European Communities submits that the MERCOSUR exemption was not necessary for the formation of MERCOSUR. Article XXIV:8(a)(i) explicitly exempts measures consistent with Article XX from the requirement to eliminate barriers to trade with respect to substantially all the trade between the constituent members of a customs union. For this reason, it follows that Article XX cannot be invoked in order to justify the selective elimination of such trade barriers only with respect to trade within the customs union or free trade area. Nor can the MERCOSUR exemption be characterized as necessary for the formation of MERCOSUR because it was adopted several years after the conclusion of MERCOSUR.

(d) The MERCOSUR Exemption and Article XX(d) of the GATT 1994

51. The European Communities submits that the MERCOSUR exemption is also not justified under Article XX(d) of the GATT 1994. The Appellate Body found, in *Mexico – Taxes on Soft Drinks*, that the term "laws and regulations" in Article XX(d) covered "rules that form part of the domestic legal system of a WTO Member, including rules deriving from international agreements that have been incorporated into the domestic legal system of a WTO Member".<sup>76</sup> However, Brazil has not demonstrated that the obligation to comply with rulings of the MERCOSUR arbitral tribunals has been incorporated into the Brazilian legal system. The European Communities suggests further that the term "securing compliance" in Article XX(d) does not mean simply "complying". Instead, "securing compliance" refers to enforcement measures where compliance is achieved by persons other than the entity "securing" the compliance. Thus, Article XX(d) does not cover Brazil's adoption of the MERCOSUR exemption. Furthermore, the MERCOSUR exemption is not "necessary" within the meaning of Article XX(d) because Brazil could have complied with the ruling of the MERCOSUR arbitral tribunal by lifting the Import Ban with respect to all third countries, rather than only its MERCOSUR partners. Finally, the European Communities submits that the MERCOSUR exemption does not fulfill the requirements of the chapeau of Article XX, because it constitutes unjustifiable and arbitrary discrimination between countries where the same conditions prevail, in particular, given that, by virtue of it, Brazil allows the imports of retreaded tyres from MERCOSUR countries even when those tyres are made from used tyres originating in the European Communities.

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<sup>75</sup>European Communities' appellant's submission, para. 392.

<sup>76</sup>*Ibid.*, para. 402 (quoting Appellate Body Report, *Mexico – Taxes on Soft Drinks*, para. 79).

B. *Arguments of Brazil – Appellee*

I. The Necessity Analysis

52. Brazil maintains that the Panel properly found that the Import Ban was "necessary" to protect human, animal, or plant life or health within the meaning of Article XX(b) of the GATT 1994, and therefore requests the Appellate Body to uphold this finding.

(a) The Contribution Analysis

53. First, Brazil argues that the Panel correctly assessed the contribution made by the Import Ban to the achievement of its objective. The paragraphs set out in Article XX focus on the measure, as such, while the chapeau focuses also on the application of the measure. Therefore, actual contribution is not relevant to the analysis under paragraph (b) of Article XX, and the Panel applied the correct legal standard in using phrases such as "can contribute" and "capable of contributing".<sup>77</sup> Such a standard is also particularly appropriate given that some measures—for example, environmental measures—may not have immediate effect. The Panel's approach was in line with "virtually all" other cases that have examined a measure's contribution under paragraphs (b) and (d) of Article XX of the GATT 1994 or under Article XIV of the *General Agreement on Trade in Services* (the "GATS").<sup>78</sup> This is the case whether the risk sought to be avoided is direct or indirect. Brazil adds that the need to undertake the weighing and balancing exercise also illustrates that the European Communities cannot be correct. If a panel were required to assess the extent of a measure's actual contribution, it would have to do the same for alternative measures in order to compare them. Yet, this is impossible, because an alternative measure is one that has not yet been realized. That the Panel was not, as the European Communities claims, required to quantify the Import Ban's contribution to reducing waste tyre volumes is confirmed in the Appellate Body Report in *EC – Asbestos*, where the Appellate Body held that "a risk may be evaluated either in quantitative or qualitative terms".<sup>79</sup> Brazil also expresses its understanding that, according to existing case law, if the measure can make a contribution to its objective, and no reasonably available alternatives exist, then the measure is "necessary".

54. In addition, Brazil argues that the Panel acted consistently with its duty under Article 11 of the DSU in finding that the Import Ban contributed to the achievement of its objective. The Panel relied on numerous studies and reports, which provided it with more than a sufficient basis to find that

<sup>77</sup>Brazil's appellee's submission, para. 74 (referring to Panel Report, paras. 7.118 and 7.142).

<sup>78</sup>*Ibid.*, para. 77 (referring to Panel Report, *US – Gambling*, para. 6.494; Panel Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 7.217; Panel Report, *Korea – Various Measures on Beef*, para. 658; and GATT Panel Report, *US – Section 337 Tariff Act*, para. 5.31).

<sup>79</sup>*Ibid.*, para. 81 (quoting Appellate Body Report, *EC – Asbestos*, para. 167). (emphasis added by Brazil)

tyres used in Brazil are retreadable and are being retreaded. The Panel referred to the ABR Report<sup>80</sup> and INMETRO Technical Note 001/2006<sup>81</sup> merely as examples of such reports and studies. In addition, the Panel's reliance on INMETRO Technical Note 001/2006, rather than on an earlier INMETRO note, was justified, because it is well established that a panel may rely on evidence that post-dates the panel's establishment, and because Brazil had explained why it was not appropriate for the Panel to rely on the earlier INMETRO note. The mere fact that the Panel did not describe its conclusions on each piece of evidence—or respond to each of the European Communities' objections—does not mean that it did not consider the evidence. The European Communities may disagree with the weight the Panel assigned to the various factual elements before it, but there is no indication that the Panel exceeded its discretion as the trier of fact.

55. As regards numerous other arguments raised by the European Communities, Brazil identifies evidence that provides support for the Panel's findings that retreaded tyres have a shorter lifespan than new tyres and that new tyres are retreadable and are being retreaded in Brazil, and asserts that the Panel did not, as the European Communities claims, base its findings on speculation about future events. Brazil also emphasizes that imports of used tyres under court injunctions and imports of retreaded tyres under the MERCOSUR exemption are extraneous to the Import Ban and do not properly form part of the "necessity" analysis.

(b) Alternatives to the Import Ban

56. Brazil contends that the Panel correctly determined that none of the measures suggested by the European Communities constituted a reasonably available alternative to the Import Ban. As a preliminary matter, Brazil contends that the European Communities' appeal on this issue is premised on a mistaken understanding of Brazil's chosen level of protection. Brazil is *not* seeking to reach a fixed level of health and safety, or only to protect against mosquito-borne diseases and tyre fire emissions (accumulation risks). Rather, it seeks to reduce accumulation, transportation, and disposal risks associated with the generation of waste tyres in Brazil *to the maximum extent possible*. Because the Panel's finding of fact correctly identified the level of protection sought by Brazil, and the European Communities, in its appeal, does not challenge this finding under Article 11 of the DSU, the European Communities' claims of error regarding reasonably available alternatives fall outside the scope of appellate review.

<sup>80</sup>*Supra*, footnote 41.

<sup>81</sup>*Supra*, footnote 42.

57. Taking account of the proper definition of its chosen level of protection (including against disposal risks), Brazil asserts that the Panel properly recognized that stockpiling, landfilling, co-incineration, and material recycling all present risks to human health and the environment. The Panel also correctly dismissed a better enforcement of the import ban on used tyres as an alternative to the Import Ban, because such a measure would not allow Brazil to reduce the number of additional waste tyres generated by imported short-lifespan retreaded tyres. Brazil also rejects the European Communities' assertion that the Panel applied an incorrect definition of "alternative", because, for Brazil, an alternative must allow a Member to achieve its chosen level of protection, and that level requires a reduction to the maximum extent possible of risks arising from waste tyre accumulation, transportation, and disposal risks. Because the Panel correctly defined Brazil's level of protection, it was also correct to consider that other complementary measures to reduce the overall number of waste tyres were not "alternatives" to the Import Ban on retreaded tyres. Brazil adds that, contrary to the European Communities' claims on appeal, the Panel did not require a single alternative measure to achieve fully the desired objective, did not refuse to consider the proposed alternatives collectively, and did not focus on whether options were actually being employed instead of whether they were reasonably available.

58. Furthermore, Brazil argues that the Panel's findings on the availability of alternative measures rested on an objective assessment of the facts, as required by Article 11 of the DSU. According to Brazil, the Panel based its finding that disposal of waste tyres presents serious health and environmental risks on an extensive factual record. The evidence on record fully supports the Panel's finding that landfilling of *both* whole and shredded waste tyres presents human health and environmental risks. Brazil also argues that the Panel's reference to the fact that the European Communities prohibits landfilling was relevant, because the health and environmental objectives listed in the European Communities' Council Directive 1999/31/EC of 26 April 1999 on the landfill of waste<sup>82</sup> mirror Brazil's objective. Furthermore, the Brazilian legislation that allowed landfilling, and which the European Communities claims the Panel should have taken into account, was a temporary measure adopted in a single Brazilian state to combat a significant increase in dengue cases. That legislation does not demonstrate that landfilling is safe, but only that, in those circumstances, the short-term need to combat dengue was more pressing.

<sup>82</sup>Exhibit BRA-42 submitted by Brazil to the Panel.

59. In relation to stockpiling, Brazil submits that the evidence on record, including a study by the California Environmental Protection Agency<sup>83</sup>, supports the Panel's finding that stockpiling presents human health and environmental risks. Furthermore, the European Communities itself acknowledges that "controlled stockpiling is *not a final disposal operation*" but merely 'temporary storage.'<sup>84</sup> As regards co-incineration, the evidence on record fully supports the Panel's finding that incineration of waste tyres presents risks to human health, that toxic emissions from the incineration of tyres cannot be eliminated, and that these emissions are higher than those generated by the burning of conventional fuels. In the light of these acknowledged risks, it would not have made sense, as the European Communities now argues, for the Panel to have required Brazil to provide evidence on co-incineration in Brazil rather than in other countries, or to use increased co-incineration as an alternative. The Panel acted within its discretion in determining the weight attributed to several reports that the European Communities considers outdated and, in any event, the evidence relied upon by the Panel is not as "outdated", nor is the evidence cited by the European Communities as "recent", as the European Communities claims on appeal. The Appellate Body, therefore, should reject the European Communities' attempts to have it second-guess the Panel's appreciation of the evidence.

60. In relation to material recycling, Brazil submits that the Panel did not consider only civil engineering in reaching its findings on alternative measures. The Panel also considered evidence related to rubber asphalt, use of rubber granulates, and devulcanization. Nor did the Panel base its finding that material recycling applications could not dispose of existing volumes of waste tyres on evidence of devulcanization alone. Instead, contends Brazil, the Panel cited documents suggesting that material recycling applications *collectively* lacked adequate disposal capacity.

(c) The Weighing and Balancing Process

61. Brazil asserts that the Panel properly weighed and balanced the relevant factors and proposed alternatives in determining that the Import Ban was "necessary" within the meaning of Article XX(b) of the GATT 1994, and that the European Communities' appeal on this point amounts to mere disagreement with the Panel's exercise of its discretion in determining which evidence to rely upon in support of its findings. The Panel expressly recognized that the Import Ban is highly trade restrictive, but rejected the European Communities' argument that this fact alone precluded a finding that the ban was "necessary". Instead, the Panel properly recognized that there may be circumstances in which a highly restrictive measure is nonetheless necessary and, in the process of weighing and balancing,

<sup>83</sup>California Environmental Protection Agency (US), Integrated Waste Management Board, "Increasing the Recycled Content in New Tyres" (May 2004) (Exhibit BRA-59 submitted by Brazil to the Panel).

<sup>84</sup>Brazil's appellee's submission, para. 154 (quoting European Communities' appellant's submission, para. 255), (emphasis added by Brazil)

identified the specific circumstances of this case that led it to such a conclusion. With respect to the question of contribution, Brazil recalls its position that Article XX(b) does not require a party to quantify the measure's contribution to the objective pursued. In any event, the Import Ban's contribution is substantial "because it reduced imports of retreaded tyres from 18,455 tons in 1999 to 1,727 tons in 2005 (over 90 percent)."<sup>85</sup> Brazil also argues that, because imports of retreaded tyres, by definition, increase the amount of waste tyres in Brazil, the relationship between the Import Ban and Brazil's goal of reducing waste tyre risks to the maximum extent possible is both direct and certain.

2. The Chapeau of Article XX of the GATT 1994

(a) The MERCOSUR Exemption

62. Brazil argues that the Panel correctly held that the MERCOSUR exemption did not result in the Import Ban being applied in a manner that constituted "arbitrary or unjustifiable" discrimination or "a disguised restriction on international trade" within the meaning of the chapeau of Article XX of the GATT 1994. Accordingly, Brazil requests the Appellate Body to reject the European Communities' claims of error and to uphold the Panel's findings in this respect.

63. Brazil asserts that the Panel properly interpreted the meaning of the word "arbitrary" in the chapeau of Article XX, in accordance with the customary rules of interpretation of public international law. The Panel took into account the ordinary meaning of the word, along with both the context and the object and purpose of the chapeau of Article XX, as well as previous panel and Appellate Body reports. On this basis, the Panel interpreted the word "arbitrary" "as lacking a reasonable basis and requiring the need to convincingly explain the rationale of the measure".<sup>86</sup>

64. Brazil disputes the European Communities' assertion that what constitutes arbitrary discrimination must be determined in relation to the objective of the measure. The specific contents of the measure at issue, including its policy objective, must be examined under the exceptions listed in the paragraphs of Article XX. The chapeau of Article XX, in turn, requires panels to examine whether the measure at issue is applied reasonably, in a manner that does not result in an abusive exercise of a Member's right to pursue its policy objective. Brazil emphasizes that the European Communities' interpretation would impermissibly narrow the scope of the chapeau of Article XX and limit the flexibility that Members have to protect legitimate values under that provision. Brazil adds that, in any event, in this case the Panel did consider imports under the MERCOSUR exemption in

<sup>85</sup>Brazil's appellee's submission, para. 177 (referring to Panel Report, para. 4.54; and Brazil's response to Question 40 posed by the Panel, Panel Report, p. 270).

<sup>86</sup>*Ibid.*, para. 191 (referring to Panel Report, paras. 7.260, 7.273, and 7.283).

relation to the objective of the measure at issue when it determined that, at the time of its examination, volumes of retreaded tyres imported under the MERCOSUR exemption did not significantly undermine the objective of the Import Ban. Furthermore, reasons Brazil, it would *not* have been reasonable or rational, in the light of the objective of the Import Ban, for Brazil to have implemented the MERCOSUR ruling by abolishing the ban altogether, as the European Communities suggests.

65. Brazil considers that the Panel correctly found that the discrimination resulting from the MERCOSUR exemption was not arbitrary. In Brazil's view, even under the European Communities' definition of "arbitrary", the following considerations identified by the Panel demonstrate that the MERCOSUR exemption did not amount to arbitrary discrimination: (i) Brazil introduced the exemption only after a dispute settlement tribunal established under MERCOSUR ruled that the ban violated Brazil's obligations under MERCOSUR; (ii) the MERCOSUR ruling was adopted in the context of an agreement intended to liberalize trade that is expressly recognized in Article XXIV of the GATT 1994; (iii) agreements of the type recognized by Article XXIV inherently provide for discrimination; (iv) Brazil had an obligation under international law to implement the ruling by the MERCOSUR tribunal; (v) Brazil applied the MERCOSUR ruling in the most narrow way possible, that is, by exempting imports of a particular kind of retreaded tyres (remoulded) from the application of the ban; and (vi) it was not reasonable for Brazil to implement the MERCOSUR ruling with respect to imports from all sources, because doing so would have forced Brazil to abandon its policy objective and its chosen level of protection. The Panel appropriately determined that these circumstances provided a rational basis for enacting the MERCOSUR exemption. Brazil rejects as a "blatant misrepresentation"<sup>87</sup> the European Communities' argument that the Panel's finding necessarily implies that mere compliance with any international agreement would exclude the existence of arbitrary discrimination, particularly given that the Panel expressly stated that its finding was limited to the "specific circumstances of the case".<sup>88</sup> Furthermore, the European Communities' systemic concerns in this respect are contrary to the well-established precept under general international law that "bad faith on the part of States is not to be presumed"<sup>89</sup>, and it is "absurd"<sup>90</sup> to suggest that a WTO Member would conclude an agreement under Article XXIV for purposes of circumventing the requirements of the chapeau of Article XX.

66. Brazil also submits that the Panel correctly concluded that the legal standard under the chapeau of Article XX is different from the legal standard under Article XXIV. As Brazil argued

<sup>87</sup>Brazil's appellee's submission, para. 209.

<sup>88</sup>*Ibid.*, para. 210 (quoting Panel Report, para. 7.283).

<sup>89</sup>*Ibid.*, para. 213. (footnote omitted)

<sup>90</sup>*Ibid.*, para. 214.

before the Panel, a measure that does not meet the requirements of Article XXIV can nevertheless meet the requirements of the chapeau of Article XX.

67. Brazil considers that the Panel correctly found that the operation of the MERCOSUR exemption has not resulted in the Import Ban being applied in a manner that would constitute unjustifiable discrimination. Brazil has difficulty understanding the European Communities' objections to the Panel's analysis since the European Communities itself argues that what constitutes arbitrary or unjustifiable discrimination must be established in relation to the objective of the measure at issue, and the Panel did precisely that. The Panel determined how Brazil's policy objective of reducing unnecessary generation of tyre waste to the maximum extent possible was being affected by imports of retreaded tyres under the MERCOSUR exemption. The level of imports and their effect on the objective of the Import Ban were relevant, in particular, because the chapeau of Article XX focuses on the application of the measure at issue. Brazil also explains that the level of imports could not rise to a level that would undermine the objective of the Import Ban in the future, because Resolution No. 38 of the Câmara de Comércio Exterior (Chamber of Foreign Trade) of 22 August 2007<sup>91</sup> established annual limits on the number of retreaded tyres that can be imported into Brazil from MERCOSUR countries. According to Brazil, these import volumes "correspond roughly" to the import volumes that the Panel found "were not significant".<sup>92</sup>

68. Brazil considers that the European Communities' reference to the right of Members to challenge measures, as such, is misplaced. The chapeau of Article XX requires an examination of the manner in which a measure is being applied, and this will "rarely" be based on "immutable, static situations".<sup>93</sup> The European Communities' challenge to the Panel's finding that 2,000 tons of retreaded tyres is "insignificant" is similarly without merit. According to Brazil, it is worth noting that the level of 2,000 tons is only one seventh of the 14,000 tons previously imported from the European Communities and, in any event, the Panel's finding that 2,000 tons is not a significant amount is a factual finding that cannot be revisited on appeal.

69. In addition, Brazil submits that the Panel's finding that the MERCOSUR exemption did not result in the Import Ban being applied in a manner that constitutes "a disguised restriction on international trade" under the chapeau of Article XX is legally sound, and refers to its arguments before the Panel in support of this position.

<sup>91</sup>Exhibit BRA-175 submitted by Brazil to the Appellate Body.

<sup>92</sup>Brazil's appellee's submission, para. 225 (referring to Panel Report, para. 7.288).

<sup>93</sup>*Ibid.*, para. 229.

(b) Imports of Used Tyres

70. Brazil submits that the Panel committed no error in the analytical approach it adopted in determining whether imports of used tyres under court injunctions resulted in the Import Ban being applied in a manner that constituted "arbitrary discrimination", "unjustifiable discrimination", or "a disguised restriction on international trade" within the meaning of the chapeau of Article XX of the GATT 1994. Brazil requests the Appellate Body to reject the European Communities' claims of error and to uphold the Panel's findings that the imports of used tyres did not constitute "arbitrary discrimination" and constituted "unjustifiable discrimination" or "a disguised restriction on international trade" within the meaning of that provision only to the extent that import volumes of used tyres "significantly undermined" the objective of the Import Ban.

71. Brazil argues that the Panel correctly found that the imports of used tyres under court injunctions did not result in the Import Ban being applied in a manner that constituted "arbitrary discrimination". The Panel was satisfied, on the basis of the evidence before it, that there was a rational basis for the importation of used tyres. Furthermore, as it did in the context of the MERCOSUR exemption, the Panel did analyze whether the imports of used tyres significantly undermined the objective of the Import Ban—that is, it took the very approach advocated by the European Communities. The Panel did *not*, as the European Communities now claims, draw a distinction between the actions of certain Brazilian courts granting injunctions and the compliance by Brazilian administrative authorities with those court injunctions. Brazil also rejects the European Communities' allegation that there is a contradiction between the actions of different branches of the Brazilian government. Rather, insists Brazil, the Import Ban, the court injunctions, and the enforcement of the injunctions by the customs authorities were the result of the operation of the Rule of Law. "There is nothing unpredictable, irrational, abnormal, unreasonable, or even illegal in the conduct of Brazil's legislative, executive, or judiciary branches."<sup>94</sup>

72. With respect to the Panel's analysis of "unjustifiable discrimination", Brazil submits that it was appropriate for the Panel to consider the level of imports of used tyres. For the same reasons that Brazil articulated with respect to the MERCOSUR exemption, the effect that the volume of imports of used tyres had on Brazil's ability to achieve its policy objective was relevant to the Panel's analysis of unjustifiable discrimination. Brazil points out the inconsistencies in the European Communities' arguments, which, on the one hand, criticize the Panel for taking into account the effects of import volumes on Brazil's ability to achieve its policy objective, and, on the other hand, insist that arbitrary and unjustifiable discrimination can be established only when analyzed in relation to the objective of

<sup>94</sup>Brazil's appellee's submission, para. 245.

the measure at issue. Brazil disputes the European Communities' assertion that the Panel's analysis of the volume of imports involves uncertainty for implementation of its report. According to Brazil, monitoring of a WTO Member's compliance is an integral part of the dispute settlement mechanism, and there are various examples of cases where panels made findings that were based on facts and circumstances that were potentially subject to change.<sup>95</sup>

73. Finally, Brazil argues that the Panel correctly considered the volume of imports of used tyres as part of its determination that the Import Ban was being applied in a manner that constituted "a disguised restriction on international trade", and refers to the arguments it made before the Panel in support of this position.

3. The European Communities' Conditional Appeal

(a) The Panel's Exercise of Judicial Economy

74. Brazil considers that the Panel was justified in deciding to exercise judicial economy with respect to the European Communities' separate claims that the MERCOSUR exemption was inconsistent with Articles I:1 and XIII:1 and not justified under Articles XX(d) and XXIV of the GATT 1994. In the light of the Panel's finding that the Import Ban was inconsistent with Article XI:1 of the GATT 1994, a separate finding in relation to an exemption to the Import Ban was not necessary to secure a positive resolution of the dispute. The MERCOSUR exemption could not exist in the absence of the Import Ban, which had previously been found to be inconsistent with the GATT 1994. The allegedly limited basis for the Panel's finding of inconsistency under Article XI:1 is not relevant, because Article 3.7 of the DSU "does not distinguish between different *degrees* of solutions".<sup>96</sup> Brazil also distinguishes the facts of this case from those in *EC – Export Subsidies on Sugar*, on the basis that "the remedies under the GATT and the DSU for a violation of Article XI (found by the Panel) are no different from the remedies for a violation of Article XIII or I."<sup>97</sup> Furthermore, the very condition on which the European Communities appeals the Panel's exercise of judicial economy contradicts its contention that separate rulings under Article I:1 and Article XIII:1 were necessary. According to Brazil, by conditioning its appeal on a finding by the Appellate Body that the MERCOSUR exemption does not result in the Import Ban being applied inconsistently with Article XX, the European Communities is implicitly recognizing that a finding that the Import Ban is

not justified under Article XX renders unnecessary findings on its separate claims under Articles I:1 and XIII:1.

(b) Completing the Legal Analysis

75. In the event the Appellate Body were to reverse the Panel's decision to exercise judicial economy, Brazil submits that the Appellate Body does not have a sufficient basis on which to complete the analysis of the European Communities' claims that the MERCOSUR exemption is inconsistent with Articles I:1 and XIII:1, and with respect to Brazil's related defences under Articles XXIV and XX(d) of the GATT 1994. There are neither undisputed facts nor factual findings by the Panel concerning the consistency of MERCOSUR with Article XXIV:5(a) and 8(a) of the GATT 1994 or the justification of the MERCOSUR exemption under Article XX(d). Brazil specifically contests, as it did before the Panel, assertions made by the European Communities regarding intra-MERCOSUR liberalization of the automotive and sugar sectors, as well as with respect to alleged exceptions to the common external tariff. In addition, the European Communities' claims under Articles XIII:1 and I:1, and Brazil's related defence under Article XXIV, are not suitable for completion of the analysis, because they are not closely related to the provisions examined by the Panel, and because they involve novel legal issues that have not been explored in depth by the parties. Brazil cites as examples of such unexplored issues the questions of what constitutes "substantially all the trade" under Article XXIV:8(a)(i) and what constitutes "substantially the same duties and other regulations of commerce" under Article XXIV:8(a)(ii).

(c) The MERCOSUR Exemption and Article XXIV of the GATT 1994

76. In the event the Appellate Body considers it can complete the analysis with respect to the separate claims made by the European Communities in relation to the MERCOSUR exemption, Brazil submits that this measure is justified under Article XXIV of the GATT 1994.

77. Brazil argues that it submitted sufficient evidence before the Panel to make a *prima facie* case that MERCOSUR meets the requirements of Article XXIV:5(a) and 8(a). In particular, Brazil submitted the results of calculations made by the Secretariat for MERCOSUR and the WTO Secretariat showing that the duties and other regulations of commerce applied at the time of MERCOSUR's formation (1995), and in 2006, were not "on the whole" higher or more restrictive than those applied prior to its formation. Brazil further suggests there is evidence on record demonstrating that "substantially all the trade" between constituent members of MERCOSUR has been liberalized, and that MERCOSUR countries maintain substantially the same duties and other regulations of commerce on trade *vis-à-vis* third countries, thus complying with the requirements of Article XXIV:8(a). Brazil notes in this regard that, before the Panel, it incorporated by reference all

<sup>95</sup>See Brazil's appellee's submission, para. 253 (referring to Panel Report, *US – Section 301 Trade Act*, paras. 7.131-7.136, 7.170, 7.179, and 7.185; and Panel Report, *US – Shrimp (Article 21.5 – Malaysia)*, para. 6.1).

<sup>96</sup>*Ibid.*, para. 268. (original emphasis)

<sup>97</sup>*Ibid.*, para. 269.

of the documents submitted by MERCOSUR members to the Committee on Regional Trade Agreements (the "CRTA").

78. Brazil contends that the European Communities has failed to rebut Brazil's *prima facie* demonstration that MERCOSUR is consistent with the requirements of Article XXIV:5 and 8. The fact that the CRTA and the Committee on Trade and Development did not reach the conclusion that MERCOSUR is in compliance with Article XXIV does not suggest that MERCOSUR is inconsistent with Article XXIV, in particular, because Members' measures are presumed WTO-consistent until sufficient evidence is presented to prove the contrary, and because the CRTA has only once concluded that a regional trade agreement was compatible with the GATT 1994.

79. In addition, Brazil maintains that the European Communities failed to substantiate its claims that MERCOSUR was inconsistent with Article XXIV. Although the European Communities asserts that the automotive and sugar sectors within MERCOSUR have not been fully liberalized, this is contradicted by the evidence it submitted to the Panel. According to Brazil, evidence before the Panel demonstrated that "the automotive sector has been the subject of continuing and progressive liberalization [and that] bilateral agreements between Mercosur members have already led, in practice, to duty-free trade in almost 100 percent of the commerce in the auto sector."<sup>98</sup> Brazil suggests further that the sugar sector alone cannot prevent compliance with the requirement under Article XXIV:8(a)(i) that "substantially all the trade" between the constituent territories be liberalized, because it "accounts for less than 0.001 percent of the total [trade]."<sup>99</sup> As regards the European Communities' assertion that there are exceptions to MERCOSUR's common external tariff, Brazil submits that the evidence on record demonstrates that MERCOSUR "applies a common external tariff to products in over 90 percent of the tariff lines and has a specific timetable in place to cover the remaining categories of products by 2008."<sup>100</sup> Brazil also rejects the European Communities' assertion that MERCOSUR does not meet the requirement under Article XXIV:5(a) that non-tariff barriers on trade with third countries not be "on the whole ... more restrictive"<sup>101</sup>, noting that the only example provided by the European Communities is the Import Ban itself. According to Brazil, a single measure cannot constitute sufficient evidence to show that MERCOSUR does not meet the requirements of Article XXIV:5(a).

<sup>98</sup>Brazil's appellee's submission, para. 295 (referring to Panel Report, para. 4.391; and WT/COMTD/1/Add.17, *supra*, footnote 73, p. 3).

<sup>99</sup>*Ibid.* (referring to Committee on Trade and Development, "Examination of the Southern Common Market (MERCOSUR) Agreement", WT/COMTD/1/Add.16, 16 May 2006 (Exhibit BRA-170 submitted by Brazil to the Panel), para. 14; and WT/COMTD/1/Add.17, *supra*, footnote 73, p. 3).

<sup>100</sup>*Ibid.*, para. 296 (referring to Brazil's response to Question 132 posed by the Panel, Panel Report, pp. 360-361, in turn citing WT/COMTD/1/Add.17, *supra*, footnote 73, p. 2).

<sup>101</sup>*Ibid.*, para. 297. (emphasis added by Brazil)

80. Moreover, Brazil contends that the Appellate Body's decision in *Turkey – Textiles* cannot be read as requiring Brazil to demonstrate that the MERCOSUR exemption was introduced upon the formation of a customs union, and that its formation would have been prevented if it were not allowed to introduce such a measure. The analytical approach adopted by the Appellate Body in *Turkey – Textiles* should not be applied in the present dispute, because the MERCOSUR exemption does not impose new restrictions against third countries but, rather, eliminates restrictive regulations between the parties to the customs union.<sup>102</sup> Furthermore, Brazil contends that a Member should not be allowed to demonstrate the necessity of its measure *only* as of the time a customs union is formed, because such customs unions and the integration of their members evolve and deepen over time.

81. Brazil also rejects the European Communities' argument that the fact that the text of Article XXIV:8(a)(i) exempts Article XX measures from the requirement to eliminate duties and other restrictive regulations of commerce demonstrates that the MERCOSUR exemption was not necessary for the formation of MERCOSUR. Such an interpretation would require the members of the customs union to exempt Article XX measures from internal liberalization, "lest they are later challenged by third countries for discrimination and not permitted to invoke Article XXIV to justify those measures."<sup>103</sup> Moreover, the Appellate Body has explained that "the terms of [Article XXIV:8(a)(i)] offer 'some flexibility' to the constituent members of a customs union when liberalizing their internal trade".<sup>104</sup> This flexibility in Article XXIV permits Brazil to eliminate the Import Ban in respect of MERCOSUR countries while maintaining it in respect of non-MERCOSUR countries. Brazil also emphasizes that the MERCOSUR exemption was not introduced pursuant to its obligations under Article XXIV:8(a)(i), but was rather the result of its unsuccessful attempt to defend the Import Ban before a MERCOSUR arbitral tribunal.

(d) The MERCOSUR Exemption and Article XX(d) of the GATT 1994

82. Should the Appellate Body decide to complete the analysis of the European Communities' claims under Articles I:1 and XIII:1 of the GATT 1994, Brazil submits that it should find the MERCOSUR exemption to be justified under Article XX(d) of the GATT 1994.

<sup>102</sup>For Brazil, *US – Line Pipe* is a more apposite case in the factual context of this dispute. (See Brazil appellee's submission, para. 301 (referring to Panel Report, *US – Line Pipe*, paras. 7.147 and 7.148))

<sup>103</sup>*Ibid.*, para. 307.

<sup>104</sup>*Ibid.*, para. 308 (quoting Appellate Body Report, *Turkey – Textiles*, para. 48).

83. Brazil submits that the Panel correctly interpreted and applied the term "to secure compliance" in Article XX(d), in contrast to the European Communities' interpretation that a state "secures compliance" within the meaning of Article XX(d) only when it enforces rules or regulations as regards other actors, and not when it secures its own compliance with the laws or regulations of its domestic legal system. Moreover, the Appellate Body's interpretation of Article XX(d) in *Mexico – Taxes on Soft Drinks* made no such distinction. Rather, the Appellate Body's interpretation of the text of Article XX(d) makes clear that domestic laws or regulations that ensure compliance by a state with its obligations are within the scope of that provision. Brazil also contends that it has incorporated the obligation to comply with rulings of MERCOSUR tribunals into its domestic law, and that evidence to that effect exists in the record.

84. Lastly, Brazil contends that the MERCOSUR exemption is "necessary" within the meaning of Article XX(d). Brazil argues that it could not have complied with the ruling of the MERCOSUR tribunal by simply exempting all third countries from the Import Ban, as the European Communities suggests it should have done, because this would have forced Brazil to abandon its policy objective of reducing unnecessary generation of tyre waste to the maximum extent possible.

#### C. *Arguments of the Third Participants*

85. Pursuant to Rule 24(2) and (4) of the *Working Procedures*, China, Cuba, Guatemala, Mexico, Paraguay, and Thailand chose not to file a third participant's submission but attended the oral hearing. Cuba, in its statement at the oral hearing, expressed its agreement with the Panel's findings that the Import Ban was necessary to reduce the exposure of human, animal, or plant life or health to risks arising from waste tyres. Cuba also emphasized the importance of the principle of sustainable development and environment preservation policies, and recalled that waste tyre management presents a challenge in particular for developing countries, given the significant environmental and economic costs it involves.

##### 1. Argentina

86. Argentina agrees with the Panel's finding that the Import Ban contributed to the protection of human life and health within the meaning of Article XX(b) of the GATT 1994. Argentina submits that the Panel's necessity analysis was consistent with the case law of the Appellate Body, and that "the Panel's reasoning relie[d] on facts brought to its attention by the parties."<sup>105</sup> The Panel correctly rejected the European Communities' contention that the Import Ban did not contribute to reducing the number of waste tyres, based on its conclusion that "the direct effect of [the Import Ban] is to compel

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<sup>105</sup> Argentina's third participant's submission, para. 14.

consumers of imported retreaded tyres to switch either to retreaded tyres produced domestically or to new tyres."<sup>106</sup> If the direct effect of the Import Ban were to impede additional imports of retreaded tyres with a shorter lifespan than new tyres, then it would fulfil Brazil's objective of avoiding generation and accumulation of waste tyres. Argentina underscores further that the Panel was not required to quantify the contribution of the Import Ban to the realization of the objective pursued.<sup>107</sup>

87. Argentina submits that the Panel was correct in concluding that the objective of protecting human health and life against life-threatening diseases "is both vital and important in the highest degree".<sup>108</sup> The Panel correctly found that the alternative measures identified by the European Communities aimed at reducing the number of waste tyres and at improving the management of waste tyres in Brazil, but not at preventing the generation of waste tyres to the maximum extent possible. Argentina also agrees with the Panel's finding that "the promotion of domestic retreading and enhanced retreadability of locally used tyres in Brazil would not lead to the reduction in the number of waste tyres additionally generated by 'imported short-lifespan retreaded tyres'."<sup>109</sup> For Argentina, the measures identified by the European Communities did not constitute alternatives that could be applied as a substitute for the Import Ban in preventing the generation of waste tyres to the maximum extent possible. Lastly, Argentina concludes that the Panel did not err in finding that there were no reasonably available alternatives to the Import Ban that would ensure the same level of protection to human life and health sought by Brazil.

##### 2. Australia

88. Australia submits that the Panel erred in finding that the Import Ban was "necessary" within the meaning of Article XX(b) of the GATT 1994. Article XX(b) should be interpreted so as to maintain the careful balance between the rights and obligations of WTO Members to secure their trade interests and the rights of Members to impose measures necessary to protect human, animal, or plant life or health. In Australia's view, the Panel incorrectly balanced these factors in making its findings on necessity.

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<sup>106</sup> Argentina's third participant's submission, para. 16 (quoting Panel Report, para. 7.134).

<sup>107</sup> *Ibid.*, para. 18 (referring to Appellate Body Report, *EC – Asbestos*, para. 167).

<sup>108</sup> *Ibid.*, para. 26 (referring to Panel Report, para. 7.111).

<sup>109</sup> *Ibid.*, para. 24 (quoting Panel Report, para. 7.168).

89. Australia notes that the Panel, in identifying the measure at issue, should have considered the MERCOSUR exemption in relation to a breach of Article XI:1 of the GATT 1994. Australia encourages the Appellate Body to treat the Import Ban and the MERCOSUR exemption "as an 'integrated whole'"<sup>110</sup> under Article XX(b).

90. Moreover, although the Appellate Body stated that a "necessary" measure is significantly closer to the pole of "indispensable" than to the opposite pole of simply "making a contribution", the Panel applied a definition of "necessary" that is closer to "making a contribution" than to "indispensable".<sup>111</sup> The Panel correctly considered the relative importance of the interests or values pursued by the Import Ban, but did not correctly examine the contribution of the measure to the realization of the ends pursued by it. The Panel also failed to consider adequately the restrictive impact of the Import Ban when conducting the weighing and balancing process. If the measure is properly identified as including both the Import Ban and exemptions to that ban, it is then more appropriate to determine first whether such a measure, in its totality, is necessary in the context of Article XX(b), taking into account the potential restrictive impact on international commerce, among other factors.

91. In relation to the Panel's assessment of alternative measures, Australia submits that the Panel did not properly weigh and balance possible alternatives, because it incorrectly identified the ends pursued by the measure, incorrectly limited its consideration of alternatives to those available "in reality"<sup>112</sup>, and failed to consider potential alternatives cumulatively rather than only on an individual basis. Australia also argues that the Panel incorrectly excluded a better enforcement of the import ban on used tyres as an alternative measure to the Import Ban. For Australia, there is no basis in Appellate Body case law for excluding from the necessity analysis alternatives that relate to the manner in which the relevant measure is implemented in practice. The Panel also applied an incorrect definition of "alternatives" when limiting its analysis to those measures seeking to avoid the accumulation of waste tyres generated from imported retreaded tyres. Finally, Australia disagrees with the Panel's reasoning that "complementary" measures were not "alternative" measures, because they could not be directly substituted for the Import Ban. Although the Panel recognized that a combination of measures may be appropriate where different alternatives are complementary in addressing the risk, in practice, the Panel evaluated each individual alternative measure in isolation.

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<sup>110</sup> Australia's third participant's submission, para. 5 (referring to Appellate Body Report, *EC – Asbestos*, para. 64).

<sup>111</sup> *Ibid.*, para. 6 (referring to Appellate Body Report, *Korea – Various Measures on Beef*, para. 161).

<sup>112</sup> *Ibid.*, para. 20.

92. Australia argues further that the Panel erred in finding that the MERCOSUR exemption did not constitute arbitrary or unjustifiable discrimination within the meaning of the chapeau of Article XX of the GATT 1994. In defining "arbitrary" as "motivated by capricious or unpredictable reasons", the Panel placed too much emphasis on dictionary definitions and reduced the term to "inutility".<sup>113</sup> Consistent with the Appellate Body's statement in *US – Shrimp* that "the precise meaning of the terms in the chapeau [of Article XX] may shift 'as the kind and the shape of the measures at stake vary and as the facts making up specific cases differ'"<sup>114</sup>, the Panel should have considered the specific factual situation that was before it. Australia adds that, although it accepts that compliance with an international agreement "could be considered as a factor by a panel in deciding whether discrimination was 'arbitrary'"<sup>115</sup>, this approach requires panels to "make a judgement on the status and validity of action under the agreement".<sup>116</sup>

93. With respect to the Panel's finding that unjustifiable discrimination occurs only to the extent that the objective of the Import Ban has been significantly undermined by a significant amount of imports, Australia submits that the Panel may have created a new test for the consideration of unjustifiable discrimination under the chapeau of Article XX. Australia recognizes that a measure with no real impact in practice may not constitute arbitrary or unjustifiable discrimination, but maintains that the import into Brazil of 2,000 tons of retreaded tyres per year would not appear to be insignificant or without practical impact. If the Appellate Body upholds the Panel's approach, the European Communities potentially would be forced to commence a new dispute under the DSU, either under Article 21.5 or under a newly constituted panel, in the event that imports of retreaded tyres from MERCOSUR countries increase to a level that would undermine the achievement of the objective of the Import Ban. Such re-litigation of essentially the same dispute would not ensure the prompt settlement of the dispute, as provided for in Article 3.3 of the DSU.

94. Finally, Australia considers that, for the same reasons as those presented in relation to the MERCOSUR exemption, the Panel erred in finding that the Brazilian court injunctions that permitted the importation of used tyres were not arbitrary.

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<sup>113</sup> Australia's third participant's submission, para. 38 (referring to Appellate Body Report, *US – Gasoline*, p. 23, DSR 1996:1, 3, at 21; and Appellate Body Report, *Canada – Dairy*, para. 133).

<sup>114</sup> *Ibid.*, para. 39 (referring to Appellate Body Report, *US – Shrimp*, para. 159).

<sup>115</sup> *Ibid.*, para. 42.

<sup>116</sup> *Ibid.*

3. Japan

95. Japan argues that what constitutes "arbitrary or unjustifiable discrimination" under the chapeau of Article XX of the GATT 1994 relates to the manner in which a challenged measure is applied and should not be defined in relation to the objective of that measure. The objective of a measure is relevant only to the determination of whether it falls under one of the paragraphs of Article XX, and not as an element to justify the measure's compatibility with the chapeau of that provision. The ordinary meaning of the term "arbitrary" indicates that an arbitrary discrimination test should focus primarily on *subjective* elements (such as motivations) in assessing the manner in which the measure is applied. As for the term "unjustifiable", the Panel correctly concluded that it suggests the "need to be able to 'defend' or convincingly explain the rationale for any discrimination in the application of the measure."<sup>117</sup> According to Japan, Members can reasonably provide such convincing explanation of the rationale based on *objective* elements, since they are considered to be easier to validate.

96. In addition, Japan agrees with the Panel that the importation of used tyres under court injunctions did not constitute arbitrary discrimination under the chapeau of Article XX, because the Panel focused on *subjective* elements in evaluating the manner of application of the Import Ban. For Japan, the administrative authority is obliged to follow a court order (where the authority has challenged it before the courts without success), and has no discretion not to obey it. Therefore, whether acts of all branches of a government are "arbitrary" usually needs to be examined in relation to the pertinent decision-making processes. In this case, the Panel correctly found that the actions of the Brazilian courts and those of Brazilian administrative authorities were not arbitrary. Japan adds that it does not necessarily follow that the government as a whole acted in an arbitrary manner just because acts of its difference branches contradict each other.

97. Japan next submits that the Panel was incorrect in assessing whether "unjustifiable discrimination" arose from the MERCOSUR exemption and from imports of used tyres under court injunctions on the basis of import volumes. Although import volumes may be a relevant factor in determining whether the application of a measure constitutes unjustifiable discrimination, import volumes are subject to strong fluctuation due to economic factors, and are therefore an inadequate benchmark for purposes of determining the consistency of a measure with the chapeau of Article XX. According to Japan, import volumes constitute a "vague threshold"<sup>118</sup> that would lead to disagreements between the parties as to the consistency of the measure in the implementation stage.

<sup>117</sup>Japan's third participant's submission, para. 11 (quoting Panel Report, para. 7.260).

<sup>118</sup>*Ibid.*, para. 25.

Japan suggests that Brazil's disposal capacity is a more reasonable threshold, because it is directly related to the reduction in the amount of waste tyre accumulation in Brazil. Japan adds that Brazil's disposal capacity is more easily quantifiable and less prone to fluctuation due to supply and demand than to import volumes.

98. Finally, Japan submits that the Panel erroneously exercised judicial economy with respect to the European Communities' claims that the MERCOSUR exemption was inconsistent with Articles I:1 and XIII:1 of the GATT 1994. The Panel should have examined these claims, because the European Communities had set out, in its panel request, claims that the MERCOSUR exemption as a specific measure was inconsistent with these GATT provisions. Japan considers that a panel's discretion in exercising judicial economy must not adversely affect the appropriateness of the recommendations and rulings of the DSB, which are key to the full and satisfactory settlement of a dispute.<sup>119</sup> In this case, the Panel's exercise of judicial economy prevented the satisfactory settlement of the matter, because the Panel's findings required Brazil to rectify the Import Ban only in relation to imports of used tyres under court injunctions, but did not necessarily require Brazil to address the measure's inconsistency in relation to the MERCOSUR exemption.

4. Korea

99. Korea submits that the Panel erred in concluding that the Import Ban was capable of contributing to the achievement of its objective. Korea agrees with the Panel that "there is no requirement that there be a precise measurement of the health risk involved".<sup>120</sup> However, Korea distinguishes the facts in *EC – Asbestos* from the facts in this dispute, because the measure at issue in *EC – Asbestos* "was a ban on the use of the product and the qualitative linkage was of the product to cancer"<sup>121</sup>, while in the present dispute there is no inherent danger in the product itself. In particular, when unlimited domestic production and importation from MERCOSUR countries are permitted, the statement that "numerical precision" is not required can be abused as "an excuse for any lack of effort in assessing degrees of risk".<sup>122</sup> In Korea's view, Brazil failed to demonstrate what amount of waste tyre reduction is optimal for achieving Brazil's objective and its chosen level of protection and how the limitations introduced by the Import Ban relate to any such level.

<sup>119</sup>Japan's third participant's submission, paras. 31-32 (referring to Appellate Body Report, *Canada – Wheat Exports and Grain Imports*, para. 133; and Appellate Body Report, *EC – Export Subsidies on Sugar*, paras. 330-335).

<sup>120</sup>Korea's third participant's submission, para. 8 (referring to Panel Report, paras. 7.118 and 7.119).

<sup>121</sup>*Ibid.*, para. 9.

<sup>122</sup>*Ibid.*

100. For Korea, the Panel's finding that the Import Ban was "capable of contributing to the overall reduction of the amount of waste tyres"<sup>123</sup> amounts to a violation of Article 11 of the DSU. It is unclear what the Panel understood as "capable of contributing", and the Panel should have quantified the extent of the actual contribution of the Import Ban to the achievement of its objective, particularly in the light of its subsequent finding that a quantity of 2,000 tons of retreaded tyres imported under the MERCOSUR exemption did not "significantly" undermine the objective of the measure.

101. Korea agrees with the Panel that Members can choose the level of protection they consider appropriate. However, the measure in question does not relate directly to the reduction of mosquito-borne diseases and tyre fire emissions. Rather, it is "derivative" and relates to the reduction in the number of waste tyres, which may have a "knock-on effect"<sup>124</sup> on the reduction of mosquito-borne diseases and tyre fire emissions. However, in Korea's view, the Panel failed to assess properly the relationship of the Import Ban to its stated goal of safeguarding human health through the reduction of waste tyres. For Korea, without a better assessment of whether or not the Import Ban actually results in a reduction of the accumulation of waste tyres, one cannot establish a measurable link (or, indeed, any link) to the stated health goal. Therefore, Korea reasons, "some sort of metric, even if not a precise one"<sup>125</sup>, would have been necessary for the Panel to determine the contribution of the Import Ban to the achievement of its objective. Korea considers that the European Communities provided a number of alternatives to the Import Ban, any of which individually or in combination would provide less trade-restrictive measures in achieving the stated goal.

102. Korea argues further that the Panel erred in finding that the MERCOSUR exemption did not result in the Import Ban being applied in a manner inconsistent with the chapeau of Article XX of the GATT 1994. First, Korea agrees with the Panel that the ordinary meaning of the word "arbitrary" includes the "elements of capricious, unpredictable and inconsistent".<sup>126</sup> However, the Panel assessed the MERCOSUR exemption only in the light of the meaning of the terms "capricious" and "unpredictable". According to Korea, the term "inconsistent" informs the whole meaning of "arbitrary".<sup>127</sup> This is significant, because the MERCOSUR exemption is not capricious, or unpredictable. However, the Import Ban and the MERCOSUR exemption certainly were "inconsistent" in the light of the underlying justification, that is, the protection of humans from mosquito-borne diseases and tyre fire emissions. For Korea, there is no logical way of distinguishing

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<sup>123</sup> Korea's third participant's submission, para. 10.

<sup>124</sup> *Ibid.*, para. 11.

<sup>125</sup> *Ibid.*, para. 12.

<sup>126</sup> *Ibid.*, para. 19.

<sup>127</sup> *Ibid.*, para. 20.

between retreaded tyres from a MERCOSUR country and retreaded tyres from another WTO Member in relation to the protection of human life and health objective pursued by Brazil.

103. Secondly, Korea submits that the Panel erred in finding that 2,000 tons of retreaded tyres imported from MERCOSUR countries did not significantly undermine the objective of the Import Ban. Korea asserts that the initial burden was on Brazil to establish adequately the factual link between the health goal and the measure in question, and to do so "with some certainty and demonstrability".<sup>128</sup> Thus, in the absence of such a benchmark provided by Brazil, the Import Ban is by definition "arbitrary", because it "may be applied or not applied in inconsistent manners without any factual or logical basis."<sup>129</sup> Korea argues that the Panel misinterpreted the nature of the exception provided under Article XXIV of the GATT 1994 and how it interacts with the exception under Article XX.

104. Finally, Korea argues that there was no legal basis for the Panel to find that the open-ended MERCOSUR exemption was consistent with Brazil's defence under Article XX based on the novel standard of significantly undermining the objective that the Panel had construed.<sup>130</sup> This reasoning implied that MERCOSUR imports could increase to some unknown level that might then significantly undermine the protection of human life and health objective stated by Brazil. Korea contends that the Panel's approach virtually invited future disputes. This is not consistent with Article 3.3 of the DSU, which provides that prompt settlement of disputes is a key element of the dispute settlement system. According to Korea, the Panel erred by attempting to make an "as applied" ruling based on transient facts, when the structure of the measure and the open-ended MERCOSUR exemption required an "as such" finding.

5. The Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu

105. The Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu submits that the Panel erred in its interpretation of the chapeau of Article XX of the GATT 1994, and in finding that the MERCOSUR exemption did not result in the Import Ban being applied in a manner that constituted either "arbitrary discrimination" or "a disguised restriction on international trade" within the meaning of the chapeau.

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<sup>128</sup> Korea's third participant's submission, para. 29.

<sup>129</sup> *Ibid.*

<sup>130</sup> *Ibid.*, para. 33.

106. The Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu submits that the Panel's finding that the MERCOSUR exemption did not constitute "arbitrary discrimination between countries where the same conditions prevail" was in error, because the MERCOSUR exemption "was done unpredictably".<sup>131</sup> In support of this argument, the Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu recalls that Brazil maintained a general ban on the importation of used tyres even after the formation of MERCOSUR, when Brazil should have eliminated most of the trade barriers with other MERCOSUR countries, and that Brazil even enacted new restrictions on imports when it enacted the Import Ban. Moreover, Brazil did not invoke the protection of human life and health in its defence before the MERCOSUR arbitral tribunal, and that tribunal did not specify how Brazil should implement its ruling. Brazil itself decided to adopt the MERCOSUR exemption. For these reasons, the Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu contends that "it is quite clear that no 'predictability' could be found in Brazil's trade policy, which would justify the effect of discrimination on retreaded tyres."<sup>132</sup> This lack of predictability results in the discrimination introduced by the MERCOSUR exemption being "arbitrary" within the meaning of the chapeau of Article XX.

107. In addition, the Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu argues that the MERCOSUR exemption should be considered arbitrary in the light of the objective of the Import Ban. It is uncontested that retreaded tyres exported from MERCOSUR countries into Brazil had the same potential to damage human life or health as retreaded tyres exported from non-MERCOSUR countries. For this reason, the Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu submits that, "if the protection of human life or health necessitates Brazil adopting an import ban on retreaded tyres, a loophole in the ban would undermine Brazil's asserted objective."<sup>133</sup> The MERCOSUR exemption is just such a loophole, and the discrimination that it engenders is, therefore, arbitrary.

108. The Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu argues further that the Panel erred in finding that the discrimination engendered by the MERCOSUR exemption was permissible pursuant to Article XXIV of the GATT 1994. Even assuming that MERCOSUR is consistent with Article XXIV, Article XXIV:8(a) specifically excludes measures adopted consistently with Article XX from the obligation to liberalize "substantially all the trade" within a customs union.

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<sup>131</sup>Third participant's submission of the Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu, para. 7.

<sup>132</sup>*Ibid.*, para. 13.

<sup>133</sup>*Ibid.*, para. 15.

The Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu also highlights that the objectives of Articles XX and XXIV "are diametrically opposed".<sup>134</sup>

109. The Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu also argues that the Panel erred in finding that the MERCOSUR exemption did not constitute "a disguised restriction on international trade" under the chapeau of Article XX, "because the amount of imported retreaded tyres did not increase 'significantly' following [its] introduction".<sup>135</sup> The chapeau of Article XX does not require evidence of a disruption in trade flows for a complainant to make a case that a disguised restriction exists. The "logic"<sup>136</sup> of the Appellate Body's rulings in *US – Shrimp* and in *US – Gambling* was "to discourage a [WTO] Member from adopting a measure having an adverse effect on international trade."<sup>137</sup> Therefore, a disguised restriction on international trade should be found to exist when there is a *possibility* that it does exist. The Panel's test of "significance", in contrast, clearly lacked a legal basis.

110. The Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu adds that, as a result of the MERCOSUR exemption, "the trade flow of retreaded tyres to Brazil has been changed in a manner benefiting other MERCOSUR countries"<sup>138</sup>, because these countries are now "able to import used tyres from non-MERCOSUR countries in the first place, retread them locally, and finally re-export retreaded tyres to Brazil."<sup>139</sup> The Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu concludes that international trade in retreaded tyres will be distorted, and that a disguised restriction results from such trade distortion.

111. The Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu further suggests that the Panel's findings in this dispute might cause confusion for WTO Members when assessing whether a specific measure is WTO-consistent, create a tendency for WTO Members to initiate a multiplicity of WTO disputes, and undermine the security and predictability needed to conduct future trade. These problems stem from the Panel's failure to provide clear criteria for determining what volume of imports or increase in import volumes would be considered "significant". Moreover, since import volumes are generally determined by supply and demand, the Panel's significance test, if adopted, would make it difficult for WTO Members, who do not have the power to control trade flows into

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<sup>134</sup>Third participant's submission of the Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu, para. 21.

<sup>135</sup>*Ibid.*, para. 23 (referring to Panel Report, para. 7.354).

<sup>136</sup>*Ibid.*, para. 26.

<sup>137</sup>*Ibid.* (referring to Appellate Body Report, *US – Shrimp*, paras. 166-184; and Appellate Body Report, *US – Gambling*, para. 369).

<sup>138</sup>*Ibid.*, para. 27.

<sup>139</sup>*Ibid.* (referring to Panel Report, para. 7.352).

their domestic markets, to adopt WTO-consistent measures or to eliminate WTO-inconsistent measures.

6. United States

112. The United States agrees with the European Communities that the manner in which the Panel considered the MERCOSUR exemption in its Article XX analysis was erroneous in a number of respects. First, the Panel erred in disregarding the MERCOSUR exemption when determining whether the Import Ban was "necessary" within the meaning of Article XX(b) of the GATT 1994. The MERCOSUR exemption is contained in Portaria SECEX 14/2004<sup>140</sup>, and this was the measure found by the Panel to be inconsistent with Article XI:1 of the GATT 1994. For this reason, the Panel was obliged to determine whether Brazil had established that the same measure—Portaria SECEX 14/2004—was justified under Article XX, including by considering the aspect of the MERCOSUR exemption in its necessity analysis. The United States highlights that a single sentence of Portaria SECEX 14/2004 contains both the Import Ban and the MERCOSUR exemption. According to the United States, the Panel should have considered, in determining the contribution of the measure to the ends pursued by it, the fact that retreated tyres continue to be imported due to the MERCOSUR exemption, and its failure to do so constituted a breach of Article 11 of the DSU.

113. However, the United States disagrees with the European Communities' apparent position that the contribution of the measure to the ends pursued must be evaluated quantitatively, or that demonstrating a contribution requires "verifiable" evidence of whether the measure "actually" contributed to the ends pursued.<sup>141</sup> Article XX(b) does not contain a requirement to quantify "necessity", and both quantitative and qualitative evidence may be relevant to the necessity analysis, including the analysis of the contribution of the measure to the ends pursued.

114. The United States also argues that the Panel erred in finding that the MERCOSUR exemption did not result in the Import Ban being applied in a manner that constitutes "arbitrary or unjustifiable discrimination" or "a disguised restriction on international trade", contrary to the chapeau of Article XX. First, the Panel erred in basing its finding that the MERCOSUR exemption did not constitute arbitrary discrimination on the fact that the exemption was adopted to comply with a ruling issued by a MERCOSUR tribunal. The ruling did not prescribe any specific implementation action and, more fundamentally, the United States objects to the Panel's reference to Article XXIV in the context of the MERCOSUR ruling. The United States explains that "Article XXIV does not

<sup>140</sup>See *supra*, footnote 3.

<sup>141</sup>United States' third participant's submission, para. 6 (referring to European Communities' appellant's submission, paras. 172-174).

'expressly recognize' any and all frameworks for [WTO] Members to discriminate in favor of partners in customs unions or free trade areas, but rather recognizes particular agreements that meet the conditions specified therein."<sup>142</sup> The Panel could not have properly concluded that MERCOSUR is a type of agreement expressly recognized in Article XXIV, because it made no findings as to whether MERCOSUR meets the terms of Article XXIV.

115. Secondly, the United States maintains that the Panel erred in relying on the number of retreated tyres imported into Brazil from MERCOSUR countries as a basis for its finding that the MERCOSUR exemption did not constitute "unjustifiable discrimination" or "a disguised restriction on international trade" under the chapeau of Article XX. The Panel found that the volume of imports from MERCOSUR countries appears not to have been "significant", but failed to offer any meaningful analysis of what volume would be "significant". The United States points out that import volumes may change, and that simple reliance on a figure "appears a dubious basis for the Panel's conclusion that the permitted imports will not 'undermine' the objective of the measure."<sup>143</sup> According to the United States, the chapeau of Article XX requires panels to evaluate whether unjustifiable discrimination or a disguised restriction on international trade exists, and not simply whether the discrimination that exists undermines the objective of the measure.

116. Finally, should the Appellate Body reach the European Communities' conditional appeal and decide to rule on the European Communities' separate claims that the MERCOSUR exemption is inconsistent with Articles I:1 and XIII:1 of the GATT 1994, the United States submits that Brazil may not rely on Article XXIV of the GATT 1994 as a defence. MERCOSUR has not been notified under Article XXIV as a customs union, as required by Article XXIV:7 of the GATT 1994. According to the United States, failure to notify a customs union under Article XXIV:7 does not merely render a customs union inconsistent with that paragraph; rather, pursuant to paragraph 1 of the *Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994* (the "*Understanding on Article XXIV of the GATT 1994*"), such a customs union is not consistent with Article XXIV as a whole. Members that opt not to subject their customs union to the procedures set out in Article XXIV and the *Understanding on Article XXIV of the GATT 1994* or its interpretation are not entitled to invoke that provision as a defence. Moreover, the United States notes that MERCOSUR countries notified MERCOSUR pursuant to paragraph 4(a) of the *GATT 1979 Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries* (the "Enabling Clause")<sup>144</sup> rather than under Article XXIV:7(a) of the GATT 1994. The

<sup>142</sup>United States' third participant's submission, para. 9. (original emphasis)

<sup>143</sup>*Ibid.*, para. 11.

<sup>144</sup>L/4903, 28 November 1979, BISD 26S/203.

United States argues that regional arrangements as defined under Articles 1, 2, and 3 of the Enabling Clause have different characteristics and are subject to different obligations than customs unions and free trade areas covered by Article XXIV.

### III. Issues Raised in This Appeal

117. The following issues are raised in this appeal:
- (a) with respect to the Panel's analysis of "necessity" within the meaning of Article XX(b) of the GATT 1994:
    - (i) whether the Panel erred in finding that the Import Ban is "necessary" to protect human or animal life or health<sup>145</sup>; and
    - (ii) whether the Panel breached its duty under Article 11 of the DSU to make an objective assessment of the facts;
  - (b) with respect to the Panel's interpretation and application of the chapeau of Article XX of the GATT 1994:
    - (i) whether the Panel erred in finding that the MERCOSUR exemption has not resulted in the Import Ban being applied in a manner that is inconsistent with the chapeau<sup>146</sup>; and
    - (ii) whether the Panel erred in its analysis of whether imports of used tyres under court injunctions have resulted in the Import Ban being applied in a manner that is inconsistent with the chapeau; and
  - (c) if the Appellate Body does *not* find that the MERCOSUR exemption results in the Import Ban being applied in a manner that is inconsistent with the chapeau of Article XX of the GATT 1994, then:
    - (i) whether the Panel erred in exercising judicial economy in relation to the European Communities' separate claim that the MERCOSUR exemption is inconsistent with Articles I:1 and XIII:1 of the GATT 1994; and, if so

<sup>145</sup>Panel Report, para. 7.215.

<sup>146</sup>*Ibid.*, paras. 7.289 and 7.354.

- (ii) whether the MERCOSUR exemption is inconsistent with Articles I:1 and XIII:1 and is not justified under Article XXIV or Article XX(d) of the GATT 1994.

### IV. Background and the Measure at Issue

#### A. Factual Background

118. Tyres are an integral component in passenger cars, lorries, and airplanes and, as such, their use is widespread in modern society. New passenger cars are typically sold with new tyres. When tyres need to be replaced, consumers in some countries<sup>147</sup> may have a choice between new tyres or "retreaded" tyres. This dispute concerns the latter category of tyres.<sup>148</sup> Retreaded tyres are used tyres that have been reconditioned for further use by stripping the worn tread from the skeleton (casing) and replacing it with new material in the form of a new tread, and sometimes with new material also covering parts or all of the sidewalls.<sup>149</sup> Retreaded tyres can be produced through different methods, one of which is called "remoulding".<sup>150</sup>

119. At the end of their useful life<sup>151</sup>, tyres become waste, the accumulation of which is associated with risks to human, animal, and plant life and health.<sup>152</sup> Specific risks to human life and health include:

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<sup>147</sup>We note that Brazil is not the only WTO Member that has adopted a ban on imports of retreaded tyres. According to Brazil, countries that have restricted imports of used and retreaded tyres include Argentina, Bangladesh, Bahrain, Pakistan, Thailand, and Venezuela. (Brazil's first submission to the Panel, para. 67) At the oral hearing, Brazil identified the following as countries that ban imports of retreaded tyres: Argentina, Morocco, Nigeria, Pakistan, Thailand, Tunisia, and Venezuela.

<sup>148</sup>Retreaded tyres are classified in the *International Convention on the Harmonized Commodity Description and Coding System*, done at Brussels, 14 June 1983, under subheadings 4012.11 (motor cars), 4012.12 (buses and lorries), 4012.13 (aircraft), and 4012.19 (other types). (Panel Report, para. 2.4)

<sup>149</sup>Panel Report, para. 2.1.

<sup>150</sup>"Remoulding" consists of replacing the tread and the sidewall including all or part of the lower area of the tyre. The other two methods of retreading are "top-capping", which consists of replacing only the tread, and "re-capping", which entails replacing the tread and part of the sidewall. (*Ibid.*, para. 2.2)

<sup>151</sup>The Panel assumed that, on average, a tyre—whether new or retreaded—can be used on a passenger car for five years before it becomes a used tyre. (*Ibid.*, para. 7.128)

<sup>152</sup>*Ibid.*, para. 7.109.

(i) the transmission of dengue, yellow fever and malaria through mosquitoes which use tyres as breeding grounds; and (ii) the exposure of human beings to toxic emissions caused by tyre fires which may cause loss of short-term memory, learning disabilities, immune system suppression, cardiovascular problems, but also cancer, premature mortality, reduced lung function, suppression of the immune system, respiratory effects, heart and chest problems.<sup>153</sup>

Risks to animal and plant life and health include: "(i) the exposure of animals and plants to toxic emissions caused by tyre fires; and (ii) the transmission of a mosquito-borne disease (dengue) to animals."<sup>154</sup>

120. Governments take actions to minimize the adverse effects of waste tyres. Policies to address "waste" include preventive measures aiming at reducing the generation of additional waste tyres<sup>155</sup>, as well as remedial measures aimed at managing and disposing of tyres that can no longer be used or retreaded, such as landfilling, stockpiling, the incineration of waste tyres, and material recycling.

121. The Panel observed that the parties to this dispute have not suggested that retreaded tyres used on vehicles pose any particular risks compared to new tyres, provided that they comply with appropriate safety standards. Various international standards exist in relation to retreaded tyres, including, for example, the norm stipulating that passenger car tyres may be retreaded only once.<sup>156</sup> One important difference between new and retreaded tyres is that the latter have a shorter lifespan and therefore reach the stage of being waste earlier.<sup>157</sup>

#### B. *The Measure at Issue*

122. Article 40 of Portaria No. 14 of the Secretaria de Comércio Exterior ("SECEX") (Secretariat of Foreign Trade of the Brazilian Ministry of Development, Industry, and Foreign Trade), dated 17 November 2004 ("Portaria SECEX 14/2004")<sup>158</sup> reads as follows:

<sup>153</sup>Panel Report, para. 7.109. See also *ibid.*, paras. 7.53-7.83.

<sup>154</sup>*Ibid.*, para. 7.112.

<sup>155</sup>See the Panel's finding, in paragraph 7.100 of its Report, that "policies to address 'waste' by non-generation of additional waste are a generally recognized means of addressing waste management issues", as well as footnote 1170 *thereto*, detailing the evidence on which the Panel relied in reaching this conclusion.

<sup>156</sup>*Ibid.*, para. 2.3.

<sup>157</sup>*Ibid.*, paras. 7.129 and 7.130.

<sup>158</sup>Exhibits BRA-84 and EC-29 submitted by Brazil and the European Communities, respectively, to the Panel. We note that, in November 2006, Article 40 of Portaria SECEX 14/2004 was replaced by Article 41 of Portaria SECEX No. 35 dated 24 November 2006, the text of which is identical to that of Article 40 of Portaria SECEX 14/2004. (European Communities' appellant's submission, para. 145 and footnote 18 *thereto*)

Article 40 – An import license will not be granted for retreaded tyres and used tyres, whether as a consumer product or feedstock, classified under NCM code 4012, except for remoulded tyres, classified under NCM codes 4012.11.00, 4012.12.00, 4012.13.00 and 4012.19.00, originating and proceeding from the Mercosur Member States under the Economic Complementarity Agreement No. 18.<sup>159</sup>

Article 40 of Portaria SECEX 14/2004 contains three main elements: (i) an import ban on *retreaded* tyres (the "Import Ban")<sup>160</sup>; (ii) an import ban on *used* tyres; and (iii) an exemption from the Import Ban of imports of certain retreaded tyres from other countries of the Mercado Común del Sur ("MERCOSUR") (Southern Common Market), which has been referred to in this dispute as the "MERCOSUR exemption".<sup>161</sup> The MERCOSUR exemption did not form part of previous regulations prohibiting the importation of retreaded tyres, notably Portaria SECEX No. 8 of 25 September 2000 ("Portaria SECEX 8/2000")<sup>162</sup>, but was introduced as a result of a ruling issued by a MERCOSUR arbitral tribunal.<sup>163</sup>

123. This dispute concerns the Import Ban and the MERCOSUR exemption in Article 40 of Portaria SECEX 14/2004, but not the import ban on used tyres.<sup>164</sup> In its request for the establishment of a panel<sup>165</sup>, the European Communities identified the Import Ban and the MERCOSUR exemption as distinct measures, and made separate claims against each of these measures. The European Communities claimed that the Import Ban was inconsistent with Article XI:1 of the GATT 1994, and

<sup>159</sup>See Panel Report, para. 2.7.

<sup>160</sup>Throughout this Report, reference to the "Import Ban" shall be understood as referring only to the import ban on retreaded tyres. It therefore does not include the MERCOSUR exemption, despite the fact that this exemption is contained in the same legal instrument as the Import Ban, that is, Article 40 of Portaria SECEX 14/2004.

<sup>161</sup>The MERCOSUR exemption applies exclusively to remoulded tyres, a subcategory of retreaded tyres, which result from the process of replacing the tread and the sidewall, including all or part of the lower area of the tyre. (See Panel Report, para. 2.74 and footnote 1440 to para. 7.265)

<sup>162</sup>Exhibits BRA-71 and EC-26 submitted by Brazil and the European Communities, respectively, to the Panel. See also Panel Report, para. 2.8.

<sup>163</sup>Following the adoption of Portaria SECEX 8/2000, Uruguay requested, on 27 August 2001, the initiation of arbitral proceedings within MERCOSUR. Uruguay alleged that Portaria SECEX 8/2000 constituted a new restriction of commerce between MERCOSUR countries, which was incompatible with Brazil's obligations under MERCOSUR. In its ruling of 9 January 2002, the arbitral tribunal found that the Brazilian measure was incompatible with MERCOSUR Decision CMC No. 22 of 29 June 2000, which obliges MERCOSUR countries not to introduce new *inter se* restrictions of commerce. (See Panel Report, para. 2.13; see also Exhibits BRA-103 and EC-40 submitted by Brazil and the European Communities, respectively, to the Panel) Following the arbitral award, Brazil enacted Portaria SECEX No. 2 of 8 March 2002, which eliminated the import ban for remoulded tyres originating in other MERCOSUR countries. (See Panel Report, para. 2.14; see also Exhibit BRA-78 submitted by Brazil to the Panel; see also Exhibit EC-41 submitted by the European Communities to the Panel) This exemption was incorporated into Article 40 of Portaria SECEX 14/2004.

<sup>164</sup>The European Communities confirmed, in response to questioning at the oral hearing, that it has not challenged the ban on the import of *used* tyres contained in Article 40 of Portaria SECEX 14/2004.

<sup>165</sup>WT/DS332/4, 18 November 2005. See also European Communities' first written submission to the Panel, para. 47.

could not be justified under Article XX of the GATT 1994.<sup>166</sup> The European Communities also made distinct claims that the MERCOSUR exemption was inconsistent with Article I:1 and Article XIII:1 of the GATT 1994, and could not be justified under either Article XXIV:5 of the GATT 1994 or the Enabling Clause.<sup>167</sup> In comments made during the interim review, Brazil stated that it had treated the Import Ban and the MERCOSUR exemption as two separate measures contained in the same legal instrument.<sup>168</sup>

124. Following the approach of the parties, the Panel analyzed the claim made against the Import Ban separately from the claims made against the MERCOSUR exemption. The Panel found the Import Ban to be inconsistent with Article XI:1 of the GATT 1994.<sup>169</sup> It then turned to Brazil's related defence under Article XX(b) of the GATT 1994, stating that its analysis of Brazil's justification of the violation should focus also on the Import Ban, because this was the "specific measure" that had been found to be inconsistent with Article XI:1.<sup>170</sup> Thus, according to the Panel, its analysis of the necessity of *that* specific measure should not have taken account of "elements extraneous to the measure itself" or of situations in which the Import Ban "does *not* apply (i.e. the exemption of MERCOSUR imports)."<sup>171</sup> The Panel recognized, nonetheless, that "the MERCOSUR exemption is foreseen in the very legal instrument containing the import ban".<sup>172</sup> It then included the MERCOSUR exemption in its analysis of the chapeau of Article XX, because the chapeau involves consideration of the manner in which the specific measure to be justified (in this case, the Import Ban) is applied.

125. On appeal, the European Communities indicated, in response to questioning at the oral hearing, that the Import Ban and the MERCOSUR exemption are two aspects of a single measure—that is, Article 40 of Portaria SECEX 14/2004—and that this provision is the measure at issue. Notwithstanding this position, the European Communities does not appeal the Panel's analytical approach. More specifically, the European Communities does not contend that the Panel erred in

<sup>166</sup>See, for instance, European Communities' first written submission to the Panel, paras. 89-168.

<sup>167</sup>*Supra*, footnote 144. See also European Communities' first written submission to the Panel, paras. 193-222.

<sup>168</sup>Panel Report, para. 6.17.

<sup>169</sup>The Panel found that the prohibition of the issuance of import licences for retreaded tyres has the effect of prohibiting the importation of retreaded tyres, and is thus inconsistent with Article XI:1 of the GATT 1994. (*Ibid.*, paras. 7.14, 7.15, and 7.34) In making the finding that Portaria SECEX 14/2004 is inconsistent with Article XI:1, the Panel focused on the import prohibition; its reasoning reflects the notion that an exemption from an import ban by its nature does not constitute a prohibition or restriction.

<sup>170</sup>*Ibid.*, para. 7.106.

<sup>171</sup>*Ibid.*, para. 7.107. (footnote omitted)

<sup>172</sup>*Ibid.*, para. 7.237; see also para. 6.19.

identifying and separately treating as two distinct matters before it: a claim relating to the Import Ban; and a claim concerning the discrimination introduced by the MERCOSUR exemption.

126. We observe, nonetheless, that the Panel might have opted for a more holistic approach to the measure at issue by examining the two elements of Article 40 of Portaria SECEX 14/2004 that relate to retreaded tyres *together*. The Panel could, under such an approach, have analyzed whether the Import Ban in combination with the MERCOSUR exemption violated Article XI:1, and whether that *combined* measure, or the resulting partial import ban, could be considered "necessary" within the meaning of Article XX(b).<sup>173</sup>

127. Yet, the Panel's approach reflects the manner in which the European Communities formulated its claims to the Panel, and the fact that the MERCOSUR exemption was not part of the original ban on the importation of retreaded tyres adopted by Brazil (Portaria SECEX 8/2000), but was only introduced following a ruling in 2002 by a MERCOSUR arbitral tribunal. These considerations prompt us to examine the issues appealed on the basis of the conceptual approach adopted by the Panel in defining the scope of the measure at issue, which, as indicated above, has not specifically been appealed by the European Communities.

### C. *Related Measures*

128. In addition to the Import Ban, Brazil has adopted a variety of other measures which were also challenged or discussed before the Panel. Although none of these measures are directly at issue in this appeal, we consider it useful to identify them briefly.

129. Presidential Decree 3.179, as amended<sup>174</sup>, provides sanctions applicable to conduct and activities harmful to the environment, and other provisions, and its Article 47-A subjects the importation, as well as the marketing, transportation, storage, keeping or warehousing, of imported used and retreaded tyres to a fine of R\$400/unit.

130. Resolution No. 258 of 26 August 1999 of the Conselho Nacional do Meio Ambiente ("CONAMA") (National Council for the Environment of the Ministry of the Environment) ("CONAMA Resolution 258/1999")<sup>175</sup>, as amended by CONAMA Resolution No. 301 of 21 March

<sup>173</sup>Indeed, two of the third participants in this appeal—Australia and the United States—suggest that the Panel should have adopted such an approach. (Australia's third participant's submission, paras. 4 and 5; United States' third participant's submission, para. 5)

<sup>174</sup>See *supra*, footnote 5.

<sup>175</sup>Exhibits BRA-4 and EC-47 submitted by Brazil and by the European Communities, respectively, to the Panel.

2002<sup>176</sup>, created a collection and disposal scheme that makes it mandatory for domestic manufacturers of new tyres and tyre importers to provide for the safe disposal of waste tyres in specified proportions.<sup>177</sup> CONAMA Resolution 258/1999, as amended in 2002, aims to ensure the environmentally appropriate final disposal of unusable tyres. Also, by exempting domestic retreaders from disposal obligations as long as they process tyres consumed within Brazil<sup>178</sup>, CONAMA Resolution 258/1999, as amended in 2002, seeks to encourage Brazilian retreaders to retread more domestically used tyres.

131. Brazilian states have also enacted measures aiming at reducing risks arising from the accumulation of waste tyres. Law 12.114 of the State of Rio Grande do Sul prohibits the commercialization of imported used tyres within its territory, which includes imported retreaded tyres, as well as retreaded tyres made in Brazil from imported casings.<sup>179</sup> A 2005 amendment to that law allows the importation and marketing of imported retreaded tyres provided that the importer proves that it has destroyed ten used tyres in Brazil for every retreaded tyre imported. In the case of imports of used tyre casings, however, the destruction of only one used tyre per imported tyre is required.<sup>180</sup> The State of Paraná has adopted Paraná Rodando Limpo, a voluntary programme to collect, *inter alia*, all existing unusable tyres currently discarded throughout the territory of Paraná.<sup>181</sup>

132. Finally, we note that, notwithstanding the import ban on used tyres contained in Article 40 of Portaria SECEX 14/2004, a number of Brazilian retreaders have sought, and obtained, injunctions allowing them to import used tyre casings in order to manufacture retreaded tyres from those used tyres.<sup>182</sup> Although the Brazilian government has, within the Brazilian domestic legal system, opposed these injunctions, it has had mixed results in its efforts to prevent the grant, or obtaining the reversal, of court injunctions for the importation of used tyres.<sup>183</sup>

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<sup>176</sup>Exhibit BRA-68 submitted by Brazil to the Panel.

<sup>177</sup>See para. 154 and footnote 253 thereto of this Report.

<sup>178</sup>Panel Report, para. 7.137.

<sup>179</sup>*Ibid.*, para. 2.11.

<sup>180</sup>*Ibid.*, para. 2.12.

<sup>181</sup>*Ibid.*, paras. 7.66, 7.174, 7.175, and 7.178.

<sup>182</sup>*Ibid.*, paras. 7.241 and 7.92-7.305.

<sup>183</sup>*Ibid.*, para. 7.304.

## V. The Panel's Analysis of the Necessity of the Import Ban

### A. The Panel's Necessity Analysis under Article XX(b) of the GATT 1994

133. The first legal issue raised by the European Communities' appeal relates to the Panel's finding that the Import Ban is "necessary" within the meaning of Article XX(b) of the GATT 1994.<sup>184</sup> The European Communities challenges three specific aspects of the Panel's analysis under Article XX(b). First, the European Communities contends that the Panel applied an "erroneous legal standard"<sup>185</sup> in assessing the contribution of the Import Ban to the realization of the ends pursued by it, and that it did not properly weigh this contribution in its analysis of the necessity of the Import Ban. Secondly, the European Communities submits that the Panel did not define correctly the alternatives to the Import Ban and erred in excluding possible alternatives proposed by the European Communities.<sup>186</sup> Thirdly, the European Communities argues that, in its analysis under Article XX(b), the Panel did not carry out a proper, if any, weighing and balancing of the relevant factors.<sup>187</sup> We will examine these contentions of the European Communities in turn.

#### 1. The Panel's Analysis of the Contribution of the Import Ban to the Achievement of Its Objective

134. In the analysis of the contribution of the Import Ban to the achievement of its objective, the Panel first recalled its previous findings that, through the Import Ban, Brazil pursued the objective of reducing exposure to the risks to human, animal, and plant life and health arising from the accumulation of waste tyres, and that such policy fell within the range of policies covered by paragraph (b) of Article XX of the GATT 1994.<sup>188</sup> The Panel also found that Brazil's chosen level of protection is the "reduction of the risks of waste tyre accumulation to the maximum extent possible".<sup>189</sup> In analyzing whether the Import Ban "contributes to the realization of the policy pursued, i.e. the protection of human, animal and plant life and health from the risks posed by the accumulation of waste tyres"<sup>190</sup>, the Panel examined two questions. First, the Panel sought to assess whether the Import Ban can contribute to the reduction in the number of waste tyres generated in Brazil. Secondly, the Panel sought to evaluate whether a reduction in the number of waste tyres can

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<sup>184</sup>Panel Report, para. 7.215.

<sup>185</sup>European Communities' appellant's submission, para. 166.

<sup>186</sup>*Ibid.*, para. 209.

<sup>187</sup>*Ibid.*, para. 285.

<sup>188</sup>Panel Report, para. 7.115.

<sup>189</sup>*Ibid.*, para. 7.108. (footnote omitted)

<sup>190</sup>*Ibid.*, para. 7.115.

contribute to the reduction of the risks to human, animal, and plant life and health arising from waste tyres.<sup>191</sup>

135. Regarding the first question, the Panel noted Brazil's explanation that the Import Ban would contribute to the achievement of the objective of reducing the number of waste tyres if imported retreaded tyres would be replaced either with domestically retreaded tyres made from tyres used in Brazil, or with new tyres capable of future retreading. The Panel began by examining the replacement of imported retreaded tyres with new tyres on Brazil's market.<sup>192</sup> The Panel determined that "all types of retreaded tyres (i.e. for passenger car, bus, truck and aircraft) have by definition a shorter lifespan than new tyres."<sup>193</sup> Accordingly, the Panel reasoned that "an import ban on retreaded tyres may lead to a reduction in the total number of waste tyres because imported retreaded tyres may be substituted for by new tyres which have a longer lifespan."<sup>194</sup> The Panel verified next whether there is a link between the replacement of imported retreaded tyres with domestically retreaded tyres and a reduction in the number of waste tyres in Brazil.<sup>195</sup> If retreaded tyres are manufactured in Brazil from tyres used in Brazil, the retreading of these used tyres contributes to the reduction of the accumulation of waste tyres in Brazil by "giving a second life to some used tyres, which otherwise would have become waste immediately after their first and only life."<sup>196</sup> The Panel added that "an import ban on retreaded tyres can encourage domestic retraders to retread more domestic used tyres than they might have done otherwise"<sup>197</sup>, because it "compel[s] consumers of imported retreaded tyres to switch either to retreaded tyres produced domestically or to new tyres."<sup>198</sup> The Panel then assessed whether domestic used tyres can be retreaded in Brazil. On the basis of the evidence provided by the parties, the Panel found that "at least some domestic used tyres are being retreaded in Brazil"<sup>199</sup>, that Brazil "has the production capacity to retread domestic used tyres"<sup>200</sup>, and that new tyres sold in Brazil have the potential to be retreaded.<sup>201</sup> The Panel also observed that "Article 40 of Portaria SECEX 14/2004 bans the importation of both used and retreaded tyres to Brazil" and that "the import ban on used tyres supports the effectiveness of the import ban on retreaded tyres regarding the reduction of waste

<sup>191</sup>Panel Report, para. 7.122.

<sup>192</sup>*Ibid.*, paras. 7.126-7.130.

<sup>193</sup>*Ibid.*, para. 7.130.

<sup>194</sup>*Ibid.*

<sup>195</sup>*Ibid.*, para. 7.132.

<sup>196</sup>*Ibid.*, para. 7.133.

<sup>197</sup>*Ibid.*, para. 7.134. (footnote omitted)

<sup>198</sup>*Ibid.*

<sup>199</sup>*Ibid.*, para. 7.136.

<sup>200</sup>*Ibid.*, para. 7.142.

<sup>201</sup>*Ibid.*, para. 7.137.

tyres."<sup>202</sup> The Panel concluded that the Import Ban "is capable of contributing to the reduction of the overall amount of waste tyres generated in Brazil."<sup>203</sup>

136. The Panel then turned to the question of whether the reduction in the number of waste tyres would contribute to a reduction of the risks to human, animal, and plant life and health arising from waste tyres. For the Panel, "the very essence of the problem is the actual accumulation of waste in and of itself."<sup>204</sup> The Panel added that "[f]o the extent that this accumulation has been demonstrated to be associated with the occurrence of the risks at issue, including the providing of fertile breeding grounds for the vectors of these diseases, a reduction in this accumulation, even if it does not eliminate it, can reasonably be expected to constitute a step towards the reduction of the occurrence of the diseases and the tyre fires."<sup>205</sup> The Panel concluded that:

... the prohibition on the importation of retreaded tyres is capable of making a contribution to the objective pursued by Brazil, in that it can lead to a reduction in the overall number of waste tyres generated in Brazil, which in turn can reduce the potential for exposure to the specific risks to human, animal, plant life and health that Brazil seeks to address.<sup>206</sup>

137. According to the European Communities, the Panel, in its assessment of the contribution of the Import Ban to the realization of the ends pursued by it, referred only to the potential contribution this measure might make.<sup>207</sup> The European Communities argues that the Panel applied an "erroneous legal standard"<sup>208</sup> in so doing, and that the Panel should have sought "to establish the actual contribution of the measure to its stated goals, and the importance of this contribution".<sup>209</sup> For the European Communities, the Panel was required to determine the extent to which the Import Ban makes a contribution to the achievement of its stated objective because, otherwise, it is not possible to weigh and balance properly this contribution against other relevant factors.<sup>210</sup> Accordingly, the European Communities contends, the Panel erred by not quantifying the reduction of waste tyres resulting from the Import Ban.<sup>211</sup> For the European Communities, "[t]he very indirect nature of the

<sup>202</sup>Panel Report, para. 7.139.

<sup>203</sup>*Ibid.*, para. 7.142.

<sup>204</sup>*Ibid.*, para. 7.146.

<sup>205</sup>*Ibid.*

<sup>206</sup>*Ibid.*, para. 7.148.

<sup>207</sup>European Communities' appellant's submission, para. 168.

<sup>208</sup>*Ibid.*, para. 166.

<sup>209</sup>*Ibid.*, para. 167.

<sup>210</sup>*Ibid.*, para. 171.

<sup>211</sup>*Ibid.*, para. 174.

alleged risks attributed to imported retreaded tyres should have called for a particularly diligent examination of the contribution made by the ban to the reduction of the number of the waste tyres arising in Brazil."<sup>212</sup>

138. Brazil counters that the Panel correctly assessed the contribution of the Import Ban to the achievement of its objective. Brazil argues that actual contribution is properly assessed under the chapeau of Article XX of the GATT 1994, which focuses on the application of the measure. Brazil asserts further that the Appellate Body expressly recognized, in *EC – Asbestos*, that "a risk may be evaluated either in quantitative or qualitative terms"<sup>213</sup> and, therefore, the Panel was under no obligation to quantify the Import Ban's contribution to the reduction in waste tyre volumes.

139. We begin by recalling that the analysis of a measure under Article XX of the GATT 1994 is two-tiered.<sup>214</sup> First, a panel must examine whether the measure falls under at least one of the ten exceptions listed under Article XX.<sup>215</sup> Secondly, the question of whether the measure at issue satisfies the requirements of the chapeau of Article XX must be considered.

140. We note at the outset that the participants do not dispute that it is within the authority of a WTO Member to set the public health or environmental objectives it seeks to achieve<sup>216</sup>, as well as the level of protection that it wants to obtain, through the measure or the policy it chooses to adopt.<sup>217</sup>

141. Article XX(b) of the GATT 1994 refers to measures "necessary to protect human, animal or plant life or health". The term "necessary" is mentioned not only in Article XX(b) of the GATT 1994, but also in Articles XX(a) and XX(d) of the GATT 1994, as well as in Article XIV(a), (b), and (c) of the GATS. In *Korea – Various Measures on Beef*, the Appellate Body underscored that "the word 'necessary' is not limited to that which is 'indispensable'".<sup>218</sup> The Appellate Body added:

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<sup>212</sup>European Communities' appellant's submission, para. 177.

<sup>213</sup>Brazil's appellee's submission, para. 81 (quoting Appellate Body Report, *EC – Asbestos*, para. 167). (emphasis added by Brazil)

<sup>214</sup>Appellate Body Report, *US – Gasoline*, p. 22, DSR 1996:1, 3, at 20. See also Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 64.

<sup>215</sup>In other words, the policy objective of the measure at issue must fall under the range of policies covered by the paragraphs of Article XX of the GATT 1994. (See, for instance, Appellate Body Report, *US – Shrimp*, para. 149)

<sup>216</sup>Appellate Body Report, *US – Gasoline*, p. 30, DSR 1996:1, 3, at 28.

<sup>217</sup>Appellate Body Report, *EC – Asbestos*, para. 168.

<sup>218</sup>Appellate Body Report, *Korea – Various Measures on Beef*, para. 161.

Measures which are indispensable or of absolute necessity or inevitable to secure compliance certainly fulfil the requirements of Article XX(d). But other measures, too, may fall within the ambit of this exception. As used in Article XX(d), the term "necessary" refers, in our view, to a range of degrees of necessity. At one end of this continuum lies "necessary" understood as "indispensable"; at the other end, is "necessary" taken to mean as "making a contribution to." We consider that a "necessary" measure is, in this continuum, located significantly closer to the pole of "indispensable" than to the opposite pole of simply "making a contribution to".<sup>219</sup> (footnote omitted)

142. In *Korea – Various Measures on Beef*, the Appellate Body explained that determining whether a measure is "necessary" within the meaning of Article XX(d):

... involves in every case a process of weighing and balancing a series of factors which prominently include the contribution made by the compliance measure to the enforcement of the law or regulation at issue, the importance of the common interests or values protected by that law or regulation, and the accompanying impact of the law or regulation on imports or exports.<sup>220</sup>

143. In *US – Gambling*, the Appellate Body addressed the "necessity" test in the context of Article XIV of the GATS. The Appellate Body stated that the weighing and balancing process inherent in the necessity analysis "begins with an assessment of the 'relative importance' of the interests or values furthered by the challenged measure"<sup>221</sup>, and also involves an assessment of other factors, which will usually include "the contribution of the measure to the realization of the ends pursued by it" and "the restrictive impact of the measure on international commerce".<sup>222</sup>

144. It is against this background that we must determine whether the Panel erred in assessing the contribution of the Import Ban to the realization of the objective pursued by it, and in the manner in which it weighed this contribution in its analysis of the necessity of the Import Ban. We begin by identifying the objective pursued by the Import Ban. The Panel found that the objective of the Import Ban is the reduction of the "exposure to the risks to human, animal or plant life or health arising from the accumulation of waste tyres"<sup>223</sup>, and noted that "few interests are more 'vital' and 'important' than

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<sup>219</sup>Appellate Body Report, *Korea – Various Measures on Beef*, para. 161.

<sup>220</sup>*Ibid.*, para. 164.

<sup>221</sup>Appellate Body Report, *US – Gambling*, para. 306. (footnote omitted)

<sup>222</sup>*Ibid.* In *Korea – Various Measures on Beef*, the Appellate Body observed that "[a] measure with a relatively slight impact upon imported products might more easily be considered as 'necessary' than a measure with intense or broader restrictive effects." (Appellate Body Report, *Korea – Various Measures on Beef*, para. 163)

<sup>223</sup>Panel Report, para. 7.102.

protecting human beings from health risks, and that protecting the environment is no less important."<sup>224</sup> The Panel also observed that "Brazil's chosen level of protection is the reduction of the risks of waste tyre accumulation to the maximum extent possible."<sup>225</sup> Regarding the trade restrictiveness of the measure, the Panel noted that it is "as trade-restrictive as can be, as far as retreaded tyres from non-MERCOSUR countries are concerned, since it aims to halt completely their entry into Brazil."<sup>226</sup>

145. We turn to the methodology used by the Panel in analyzing the contribution of the Import Ban to the achievement of its objective. Such a contribution exists when there is a genuine relationship of ends and means between the objective pursued and the measure at issue. The selection of a methodology to assess a measure's contribution is a function of the nature of the risk, the objective pursued, and the level of protection sought. It ultimately also depends on the nature, quantity, and quality of evidence existing at the time the analysis is made. Because the Panel, as the trier of facts, is in a position to evaluate these circumstances, it should enjoy a certain latitude in designing the appropriate methodology to use and deciding how to structure or organize the analysis of the contribution of the measure at issue to the realization of the ends pursued by it. This latitude is not, however, boundless. Indeed, a panel must analyze the contribution of the measure at issue to the realization of the ends pursued by it in accordance with the requirements of Article XX of the GATT 1994 and Article 11 of the DSU.

146. We note that the Panel chose to conduct a qualitative analysis of the contribution of the Import Ban to the achievement of its objective.<sup>227</sup> In previous cases, the Appellate Body has not established a requirement that such a contribution be quantified.<sup>228</sup> To the contrary, in *EC – Asbestos*, the Appellate Body emphasized that there is "no requirement under Article XX(b) of the GATT 1994 to *quantify*, as such, the risk to human life or health."<sup>229</sup> In other words, "[a] risk may be evaluated either in quantitative or qualitative terms."<sup>230</sup> Although the reference by the Appellate

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<sup>224</sup>Panel Report, para. 7.108 (referring to Brazil's first written submission, para. 101).

<sup>225</sup>*Ibid.* (footnote omitted)

<sup>226</sup>*Ibid.*, para. 7.114.

<sup>227</sup>*Ibid.*, para. 7.118.

<sup>228</sup>Appellate Body Report, *Korea – Various Measures on Beef*, paras. 163 and 164; Appellate Body Report, *EC – Asbestos*, para. 172; Appellate Body Report, *US – Gambling*, para. 306; Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 70.

<sup>229</sup>Appellate Body Report, *EC – Asbestos*, para. 167. (original emphasis; footnote omitted)

<sup>230</sup>*Ibid.*

to the quantification of a risk is not the same as the quantification of the contribution of a measure to the realization of the objective pursued by it (which could be, as it is in this case, the reduction of a risk), it appears to us that the same line of reasoning applies to the analysis of the contribution, which can be done either in quantitative or in qualitative terms.

147. Accordingly, we do not accept the European Communities' contention that the Panel was under an obligation to quantify the contribution of the Import Ban to the reduction in the number of waste tyres and to determine the number of waste tyres that would be reduced as a result of the Import Ban.<sup>231</sup> In our view, the Panel's choice of a qualitative analysis was within the bounds of the latitude it enjoys in choosing a methodology for the analysis of the contribution.

148. The Panel analyzed the contribution of the Import Ban to the achievement of its objective in a coherent sequence. It examined first the impact of the replacement of imported retreaded tyres with *new tyres* on the reduction of waste. Secondly, the Panel sought to determine whether imported retreaded tyres would be replaced with *domestically retreaded tyres*, which led it to examine whether domestic used tyres can be and are being retreaded in Brazil. Thirdly, it considered whether the reduction in the number of waste tyres would contribute to a reduction of the risks to human, animal, and plant life and health.

149. The Panel's analysis was not only directed at an assessment of the current situation and the *immediate* effects of the Import Ban on the reduction of the exposure to the targeted risks. The Panel's approach also focused on evaluating the extent to which the Import Ban is likely to result in a reduction of the exposure to these risks.<sup>232</sup> In the course of its reasoning, the Panel made and tested some key hypotheses, including: that imported retreaded tyres are being replaced with new tyres<sup>233</sup> and domestically retreaded tyres<sup>234</sup>; that some proportion of domestic used tyres are retreadable and are being retreaded<sup>235</sup>; that Brazil introduced a number of measures to facilitate the access of

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<sup>231</sup>European Communities, appellant's submission, para. 174.

<sup>232</sup>In the Panel's view, "it cannot be reasonably expected that the specific measure under consideration would entirely eliminate the risk ... or even that its impact on the actual reduction of the incidence of the diseases at issue would manifest itself very rapidly after the enactment of the measure." (Panel Report, para. 7.145)

<sup>233</sup>*Ibid.*, para. 7.130.

<sup>234</sup>*Ibid.*, paras. 7.133-7.135.

<sup>235</sup>*Ibid.*, para. 7.136.

domestic rereaders to good-quality used tyres<sup>236</sup>, that more automotive inspections in Brazil lead to an increase in the number of rereadable used tyres<sup>237</sup>; and that Brazil has the production capacity to reread such tyres.<sup>238</sup> The Panel sought to verify these hypotheses on the basis of the evidence adduced by the parties and found them to be logically sound and supported by sufficient evidence. In the next Section, we will examine the European Communities' claim that the Panel failed to make an objective assessment of the facts with respect to the verification of some of these hypotheses. Assuming, for the time being, that the Panel assessed the facts in accordance with Article 11 of the DSU, it appears to us that the Panel's analysis supports its conclusion that the Import Ban is capable of making a contribution and can result in a reduction of exposure to the targeted risks.<sup>239</sup> We have now to determine whether this was sufficient to conclude that the Import Ban is "necessary" within the meaning of Article XX(b) of the GATT 1994.

150. As the Panel recognized, an import ban is "by design as trade-restrictive as can be".<sup>240</sup> We agree with the Panel that there may be circumstances where such a measure can nevertheless be necessary, within the meaning of Article XX(b). We also recall that, in *Korea – Various Measures on Beef*, the Appellate Body indicated that "the word 'necessary' is not limited to that which is 'indispensable'".<sup>241</sup> Having said that, when a measure produces restrictive effects on international trade as severe as those resulting from an import ban, it appears to us that it would be difficult for a panel to find that measure necessary unless it is satisfied that the measure is apt to make a material contribution to the achievement of its objective. Thus, we disagree with Brazil's suggestion that, because it aims to reduce risk exposure to the maximum extent possible, an import ban that brings a marginal or insignificant contribution can nevertheless be considered necessary.<sup>242</sup>

151. This does not mean that an import ban, or another trade-restrictive measure, the contribution of which is not immediately observable, cannot be justified under Article XX(b). We recognize that certain complex public health or environmental problems may be tackled only with a comprehensive policy comprising a multiplicity of interacting measures. In the short-term, it may prove difficult to

<sup>236</sup>Panel Report, para. 7.137.

<sup>237</sup>*Ibid.*, para. 7.138.

<sup>238</sup>*Ibid.*, para. 7.141.

<sup>239</sup>*Ibid.*, para. 7.148.

<sup>240</sup>*Ibid.*, para. 7.211.

<sup>241</sup>Appellate Body Report, *Korea – Various Measures on Beef*, para. 161.

<sup>242</sup>Brazil's appellee's submission, paras. 80 and 83. According to Brazil, given its chosen level of protection to reduce the risk of waste tyre accumulation to the maximum extent possible, "[i]f the Panel finds that there are no reasonable alternatives to the measure, the measure is necessary—no matter how small its contribution—because the WTO does not second-guess the Member's chosen level of protection." (*Ibid.*, para. 80)

isolate the contribution to public health or environmental objectives of one specific measure from those attributable to the other measures that are part of the same comprehensive policy. Moreover, the results obtained from certain actions—for instance, measures adopted in order to attenuate global warming and climate change, or certain preventive actions to reduce the incidence of diseases that may manifest themselves only after a certain period of time—can only be evaluated with the benefit of time.<sup>243</sup> In order to justify an import ban under Article XX(b), a panel must be satisfied that it brings about a material contribution to the achievement of its objective. Such a demonstration can of course be made by resorting to evidence or data, pertaining to the past or the present, that establish that the import ban at issue makes a material contribution to the protection of public health or environmental objectives pursued. This is not, however, the only type of demonstration that could establish such a contribution. Thus, a panel might conclude that an import ban is necessary on the basis of a demonstration that the import ban at issue is apt to produce a material contribution to the achievement of its objective. This demonstration could consist of quantitative projections in the future, or qualitative reasoning based on a set of hypotheses that are tested and supported by sufficient evidence.

152. We have now to assess whether the qualitative analysis provided by the Panel establishes that the Import Ban is apt to produce a material contribution to the achievement of the objective of reducing exposure to the risks arising from the accumulation of waste tyres.

153. We observe, first, that the Panel analyzed the contribution of the Import Ban as initially designed, without taking into account the imports of remoulded tyres under the MERCOSUR exemption. As we indicated above, this is not the only possible approach. Nevertheless, we proceed with our examination of the Panel's reasoning on that basis for the reasons we explained earlier. In the light of the evidence adduced by the parties, the Panel was of the view that the Import Ban would lead to imported rereadable tyres being replaced with rereadable tyres made from local casings<sup>244</sup>, or with new tyres that are rereadable.<sup>245</sup> As concerns new tyres, the Panel observed, and we agree, that rereadable tyres "have by definition a shorter lifespan than new tyres"<sup>246</sup> and that, accordingly, the

<sup>243</sup>In this respect, we note that, in *US – Gasoline*, the Appellate Body stated, in the context of Article XX(g) of the GATT 1994, that, "in the field of conservation of exhaustible natural resources, a substantial period of time, perhaps years, may have to elapse before the effects attributable to implementation of a given measure may be observable." (Appellate Body Report, *US – Gasoline*, p. 21, DSR 1996:1, 3, at 20)

<sup>244</sup>Panel Report, paras. 7.126-7.130.

<sup>245</sup>*Ibid.*, paras. 7.131-7.142.

<sup>246</sup>*Ibid.*, para. 7.130.

Import Ban "may lead to a reduction in the total number of waste tyres because imported retreaded tyres may be substituted for by new tyres which have a longer lifespan."<sup>247</sup> As concerns tyres retreaded in Brazil from local casings, the Panel was satisfied that Brazil had the production capacity to retread domestic used tyres<sup>248</sup> and that "at least some domestic used tyres are being retreaded in Brazil."<sup>249</sup> The Panel also agreed that Brazil has taken a series of measures to facilitate the access of domestic retreaders to good-quality used tyres<sup>250</sup>, and that new tyres sold in Brazil are high-quality tyres that comply with international standards and have the potential to be retreaded.<sup>251</sup> The Panel's conclusion with which we agree was that, "if the domestic retreading industry retreads more domestic used tyres, the overall number of waste tyres will be reduced by giving a second life to some used tyres, which otherwise would have become waste immediately after their first and only life."<sup>252</sup> For these reasons, the Panel found that a reduction of waste tyres would result from the Import Ban and that, therefore, the Import Ban would contribute to reducing exposure to the risks associated with the accumulation of waste tyres. As the Panel's analysis was qualitative, the Panel did not seek to estimate, in quantitative terms, the reduction of waste tyres that would result from the Import Ban, or the time horizon of such a reduction. Such estimates would have been very useful and, undoubtedly, would have strengthened the foundation of the Panel's findings. Having said that, it does not appear to us erroneous to conclude, on the basis of the hypotheses made, tested, and accepted by the Panel, that fewer waste tyres will be generated with the Import Ban than otherwise.

154. Moreover, we wish to underscore that the Import Ban must be viewed in the broader context of the comprehensive strategy designed and implemented by Brazil to deal with waste tyres. This comprehensive strategy includes not only the Import Ban but also the import ban on used tyres, as well as the collection and disposal scheme adopted by CONAMA Resolution 258/1999, as amended in 2002, which makes it mandatory for domestic manufacturers and importers of new tyres to provide

<sup>247</sup>Panel Report, para. 7.130.

<sup>248</sup>*Ibid.*, para. 7.141. The Panel noted that, in 2005, 33.4 million new tyres (all types included) were sold in Brazil (either domestically produced or imported) and 18.6 million retreaded tyres were produced domestically.

<sup>249</sup>*Ibid.*, para. 7.136.

<sup>250</sup>*Ibid.*, para. 7.137.

<sup>251</sup>*Ibid.*

<sup>252</sup>*Ibid.*, para. 7.133.

for the safe disposal of waste tyres in specified proportions.<sup>253</sup> For its part, CONAMA Resolution 258/1999, as amended in 2002, aims to reduce the exposure to risks arising from the accumulation of waste tyres by forcing manufacturers and importers of new tyres to collect and dispose of waste tyres at a ratio of five waste tyres for every four new tyres. This measure also encourages Brazilian retreaders to retread more domestic used tyres by exempting domestic retreaders from disposal obligations as long as they process tyres consumed within Brazil.<sup>254</sup> Thus, the CONAMA scheme provides additional support for and is consistent with the design of Brazil's strategy for reducing the number of waste tyres. The two mutually enforcing pillars of Brazil's overall strategy—the Import Ban and the import ban on used tyres—imply that the demand for retreaded tyres in Brazil must be met by the domestic retreaders, and that these retreaders, in principle, can use only domestic used tyres for raw material.<sup>255</sup> Over time, this comprehensive regulatory scheme is apt to induce sustainable changes in the practices and behaviour of the domestic retreaders, as well as other actors, and result in an increase in the number of retreadable tyres in Brazil and a higher rate of retreading of domestic casings in Brazil. Thus, the Import Ban appears to us as one of the key elements of the comprehensive strategy designed by Brazil to deal with waste tyres, along with the import ban on

<sup>253</sup>Article 3 of CONAMA Resolution 258/1999, as amended in 2002, provides:

The time periods and quantities for collection and environmentally appropriate final disposal of unusable tyres resulting from use on automotive vehicles and bicycles covered by this Regulation are as follows:

I – as of 1 January 2002: for every four new tyres produced in Brazil or imported new or reconditioned tyres, including those on imported vehicles, manufacturers and importers must ensure final disposal of one unusable tyre;

II – as of 1 January 2003: for every two new tyres produced in Brazil or imported new or reconditioned tyres, including those on imported vehicles, manufacturers and importers must ensure final disposal of one unusable tyre;

III – as of 1 January 2004:

a) for every one new tyre produced in Brazil or imported new tyre, including those on imported vehicles, manufacturers and importers must ensure final disposal of one unusable tyre;

b) for every four imported reconditioned tyres, of any type, importers must ensure final disposal of five unusable tyres;

IV – as of 1 January 2005:

a) for every four new tyres produced in Brazil or imported tyres, including those on imported vehicles, manufacturers and importers must ensure final disposal of five unusable tyres;

b) for every three imported reconditioned tyres, of any type, importers must ensure final disposal of four unusable tyres.

<sup>254</sup>Panel Report, para. 7.137.

<sup>255</sup>Leaving aside, as explained above, the imports under the MERCOSUR exemption and under court injunctions.

used tyres and the collection and disposal scheme established by CONAMA Resolution 258/1999, as amended in 2002.

155. As we explained above, we agree with the Panel's reasoning suggesting that fewer waste tyres will be generated with the Import Ban in place. In addition, Brazil has developed and implemented a comprehensive strategy to deal with waste tyres. As a *key element* of this strategy, the Import Ban is likely to bring a material contribution to the achievement of its objective of reducing the exposure to risks arising from the accumulation of waste tyres. On the basis of these considerations, we are of the view that the Panel did not err in finding that the Import Ban contributes to the achievement of its objective.

2. The Panel's Analysis of Possible Alternatives to the Import Ban

156. In order to determine whether a measure is "necessary" within the meaning of Article XX(b) of the GATT 1994, a panel must assess all the relevant factors, particularly the extent of the contribution to the achievement of a measure's objective and its trade restrictiveness, in the light of the importance of the interests or values at stake. If this analysis yields a preliminary conclusion that the measure is necessary, this result must be confirmed by comparing the measure with its possible alternatives, which may be less trade restrictive while providing an equivalent contribution to the achievement of the objective pursued. It rests upon the complaining Member to identify possible alternatives to the measure at issue that the responding Member could have taken.<sup>256</sup> As the Appellate Body indicated in *US – Gambling*, while the responding Member must show that a measure is necessary, it does not have to "show, in the first instance, that there are *no* reasonably available alternatives to achieve its objectives."<sup>257</sup> We recall that, in order to qualify as an alternative, a measure proposed by the complaining Member must be not only less trade restrictive than the measure at issue, but should also "preserve for the responding Member its right to achieve its desired level of protection with respect to the objective pursued".<sup>258</sup> If the complaining Member has put forward a possible alternative measure, the responding Member may seek to show that the proposed measure does not allow it to achieve the level of protection it has chosen and, therefore, is not a genuine alternative. The responding Member may also seek to demonstrate that the proposed alternative is not, in fact, "reasonably available".<sup>259</sup> As the Appellate Body indicated in *US – Gambling*, "[a]n alternative measure may be found not to be 'reasonably available' ... where it is merely theoretical in nature, for instance, where the responding Member is not capable of taking it, or

<sup>256</sup> Appellate Body Report, *US – Gambling*, para. 311.

<sup>257</sup> *Ibid.*, para. 309. (original emphasis)

<sup>258</sup> *Ibid.*, para. 308.

<sup>259</sup> *Ibid.*, para. 311.

where the measure imposes an undue burden on that Member, such as prohibitive costs or substantial technical difficulties."<sup>260</sup> If the responding Member demonstrates that the measure proposed by the complaining Member is not a genuine alternative or is not "reasonably available", taking into account the interests or values being pursued and the responding Member's desired level of protection, it follows that the measure at issue is necessary.<sup>261</sup>

157. Before the Panel, the European Communities put forward two types of possible alternative measures or practices: (i) measures to reduce the number of waste tyres accumulating in Brazil; and (ii) measures or practices to improve the management of waste tyres in Brazil.<sup>262</sup> The Panel examined the alternative measures proposed by the European Communities in some detail, and in each case found that the proposed measure did not constitute a reasonably available alternative to the Import Ban. Among the reasons that the Panel gave for its rejections were that the proposed alternatives were already in place, would not allow Brazil to achieve its chosen level of protection, or would carry their own risks and hazards.

158. Regarding the measures to reduce the accumulation of waste tyres, the Panel first discussed measures to encourage domestic retreading or improve the retreadability of domestic used tyres. The Panel observed that these measures had already been implemented or were in the process of being implemented<sup>263</sup> so that the impact of these measures and the Import Ban "could be cumulative rather than substitutable".<sup>264</sup> Therefore, the Panel disagreed with the European Communities that "the institution of domestic measures to encourage timely domestic retreading and to improve the retreadability of domestic used tyres would achieve the same outcome as the import ban".<sup>265</sup>

159. The Panel went on to discuss the European Communities' contention that Brazil should prevent imports of used tyres into Brazil through court injunctions. The Panel noted that imports of used tyres were already prohibited by law in Brazil, "so that if the 'alternative measure' proposed by the European Communities is the prohibition of used tyres, it could be said that Brazil actually already imposes that measure."<sup>266</sup> Accordingly, the Panel concluded that the possible alternative measures identified by the European Communities to avoid the *generation* of waste tyres could not "apply *as a*

<sup>260</sup> Appellate Body Report, *US – Gambling*, para. 308.

<sup>261</sup> *Ibid.*, para. 311.

<sup>262</sup> Panel Report, para. 7.159.

<sup>263</sup> *Ibid.*, para. 7.169.

<sup>264</sup> *Ibid.*

<sup>265</sup> *Ibid.*

<sup>266</sup> *Ibid.*, para. 7.171.

*substitute*" for the Import Ban but are, rather, complementary measures that Brazil already applies, at least in part.<sup>267</sup>

160. Turning to alternatives aiming to improve management of waste tyres, the Panel examined, first, collection and disposal schemes and, secondly, disposal methods.

161. The European Communities referred mainly to two collection and disposal schemes.<sup>268</sup> In the analysis of these schemes, the Panel recalled that "Brazil's chosen level of protection is the reduction of the risks associated with waste tyre accumulation to the maximum extent possible".<sup>269</sup> According to the Panel, "insofar as the level of protection pursued by Brazil involves the 'non-generation' of waste tyres in the first place", collection and disposal schemes, such as that adopted by CONAMA Resolution 258/1999 or the Paraná Rodando Limpo<sup>270</sup> programme, "would not seem able to achieve the same level of protection as the import ban".<sup>271</sup> The Panel also noted Brazil's concern that these collection and disposal schemes do not address or eliminate disposal risks.<sup>272</sup> The Panel concluded that these schemes cannot be considered as alternatives to the Import Ban at the level of protection sought by Brazil, because they were already implemented in Brazil and do not address the risks associated with the disposal of waste tyres.<sup>273</sup>

162. The Panel then examined the following disposal methods identified by the European Communities: (i) landfilling; (ii) stockpiling; (iii) incineration of waste tyres in cement kilns and similar facilities; and (iv) material recycling.

163. Concerning *landfilling*, the Panel found that the landfilling of waste tyres may pose the very risks Brazil seeks to reduce through the Import Ban, and for this reason cannot constitute a reasonably available alternative.<sup>274</sup> For the Panel, landfilling of waste tyres poses problems, including the "instability of sites that will affect future land reclamation, long-term leaching of toxic substances, and the risk of tyre fires and mosquito-borne diseases."<sup>275</sup> The Panel also observed that the evidence

<sup>267</sup>Panel Report, para. 7.172. (original emphasis)

<sup>268</sup>The scheme adopted by CONAMA Resolution 258/1999, as amended in 2002, which makes it mandatory for domestic producers and importers of new tyres to provide for the safe disposal of waste tyres (or unusable tyres) in specified proportions; and a voluntary multi-sector programme called Paraná Rodando Limpo, which has been put in place in the State of Paraná. (See *supra*, footnote 253; see also *supra*, paras. 130 and 131)

<sup>269</sup>Panel Report, para. 7.177.

<sup>270</sup>See Exhibit EC-49 submitted by the European Communities to the Panel.

<sup>271</sup>Panel Report, para. 7.177.

<sup>272</sup>*Ibid.*

<sup>273</sup>*Ibid.*, para. 7.178.

<sup>274</sup>*Ibid.*, para. 7.186.

<sup>275</sup>*Ibid.*, para. 7.183. (footnote omitted)

it examined showing the existence of such risks did not make a clear distinction between landfilling of shredded tyres (also referred to as "controlled landfilling") and landfilling of whole tyres ("uncontrolled landfilling"). Thus, for the Panel, it was not possible to conclude that landfilling of shredded tyres does not pose risks similar to those linked to other types of waste tyre landfills.<sup>276</sup>

164. Regarding *stockpiling*<sup>277</sup>, the Panel observed that this method does not "dispose of" waste tyres<sup>278</sup>, and added that "the evidence shows that even the so-called 'controlled stockpiling' that is to say stockpiles designed to prevent the risk of fires and pests may still pose considerable risks to human health and the environment."<sup>279</sup> The Panel concluded that stockpiling did not constitute an alternative to the Import Ban.<sup>280</sup>

165. With respect to the *incineration* of waste tyres, the Panel found that sufficient evidence demonstrated that health risks exist in relation to the incineration of waste tyres, even if such risks could be significantly reduced through strict emission standards.<sup>281</sup> For the Panel, the evidence suggested that "the question still remains whether toxic chemicals emitted by incineration of waste tyres, regardless of the level of emission, may potentially pose health risks to humans."<sup>282</sup> The Panel added that, although emission levels can vary largely depending on the emission control technology, "the most up-to-date technology that can control toxic emissions to minimum levels is not necessarily readily available, mostly for financial reasons."<sup>283</sup>

166. Finally, the Panel examined *material recycling* applications. Regarding civil engineering applications using waste tyres, the Panel found that demand for these applications was fairly limited partly due to their high costs, that they are capable of disposing of only a small number of waste tyres, and that the evidence casts doubt on the safety of some of these engineering applications.<sup>284</sup> With respect to rubber asphalt, the Panel found that the information showed that "the use of rubber asphalt results in higher costs."<sup>285</sup> Consequently, "the demand for this technology is limited and its waste

<sup>276</sup>Panel Report, para. 7.184.

<sup>277</sup>Stockpiling consists of storing waste tyres in designated installations. (See European Communities' second written submission to the Panel, para. 104)

<sup>278</sup>Panel Report, para. 7.188.

<sup>279</sup>*Ibid.* (footnote omitted)

<sup>280</sup>*Ibid.*, para. 7.189.

<sup>281</sup>*Ibid.*, para. 7.194.

<sup>282</sup>*Ibid.*, para. 7.192. (footnote omitted)

<sup>283</sup>*Ibid.*, para. 7.193. (footnote omitted)

<sup>284</sup>*Ibid.*, paras. 7.201 and 7.202.

<sup>285</sup>*Ibid.*, para. 7.205.

disposal capacity is reduced."<sup>286</sup> The Panel also noted that the use of rubber granulates in the production of certain products may dispose of only a limited amount of waste tyres.<sup>287</sup> Finally, as regards devulcanization and other forms of chemical or thermal transformation, the Panel observed that, "under current market conditions, the economic viability of these options has yet to be demonstrated."<sup>288</sup> In the light of these considerations, the Panel concluded that "it is not clear that material recycling applications are entirely safe"<sup>289</sup>, and that even if they were completely harmless, "they would not be able to dispose of a quantity of waste tyres sufficient to achieve Brazil's desired level of protection due to their prohibitive costs and thus cannot constitute a reasonably available alternative".<sup>290</sup>

167. On appeal, the European Communities contends that the Panel erred in its analysis of the measures or practices that were presented as possible alternatives to the Import Ban. In particular, the European Communities submits that the Panel used in its analysis an incorrect concept of "alternative". In addition, the European Communities argues that the Panel should have considered as alternatives to the Import Ban a better enforcement of the ban on imports of used tyres and of existing collection and disposal schemes.

168. Brazil asserts that the Panel was correct in finding that none of the alternative measures suggested by the European Communities constituted "reasonably available" alternatives to the Import Ban. For Brazil, the Panel correctly took account of Brazil's chosen level of protection—that is, the reduction of risks associated with the generation of waste tyres in Brazil to the maximum extent possible—in concluding that none of the alternatives suggested by the European Communities avoided the generation of additional waste tyres in the first place.

169. The Panel examined each of the measures or practices put forward by the European Communities in order to determine whether they were reasonably available alternatives in the light of the objective of the Import Ban and Brazil's chosen level of protection.<sup>291</sup>

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<sup>286</sup>Panel Report, para. 7.205. (footnote omitted)

<sup>287</sup>*Ibid.*, para. 7.206. (emphasis and footnote omitted)

<sup>288</sup>*Ibid.*, para. 7.207. (footnote omitted)

<sup>289</sup>*Ibid.*, para. 7.208.

<sup>290</sup>*Ibid.* (footnote omitted)

<sup>291</sup>*Ibid.*, para. 7.152.

170. We note that the objective of the Import Ban is the reduction of the "exposure to the risks to human, animal or plant life or health arising from the accumulation of waste tyres"<sup>292</sup> and that "Brazil's chosen level of protection is the reduction of [these] risks ... to the maximum extent possible"<sup>293</sup>, and that a measure or practice will not be viewed as an alternative unless it "preserve[s] for the responding Member its right to achieve its desired level of protection with respect to the objective pursued".<sup>294</sup>

171. We recall that tyres—new or retreaded—are essential for modern transportation. However, at the end of their useful life, they turn into waste that carries risks for public health and the environment.<sup>295</sup> Governments, legitimately, take actions to minimize the adverse effects of waste tyres. They may adopt preventive measures aiming to reduce the accumulation of waste tyres, a category into which the Import Ban falls. Governments may also contemplate remedial measures for the management and disposal of waste tyres, such as landfilling, stockpiling, incineration of waste tyres, and material recycling. Many of these measures or practices carry, however, their own risks or require the commitment of substantial resources, or advanced technologies or know-how. Thus, the capacity of a country to implement remedial measures that would be particularly costly, or would require advanced technologies, may be relevant to the assessment of whether such measures or practices are reasonably available alternatives to a preventive measure, such as the Import Ban, which does not involve "prohibitive costs or substantial technical difficulties".<sup>296</sup>

172. Among the possible alternatives, the European Communities referred to measures to encourage domestic retreading or improve the retreadability of used tyres, as well as a better enforcement of the import ban on used tyres and of existing collection and disposal schemes. In fact, like the Import Ban, these measures already figure as elements of a comprehensive strategy designed by Brazil to deal with waste tyres.<sup>297</sup> Substituting one element of this comprehensive policy for another would weaken the policy by reducing the synergies between its components, as well as its total effect. We are therefore of the view that the Panel did not err in rejecting as alternatives to the

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<sup>292</sup>Panel Report, para. 7.102.

<sup>293</sup>*Ibid.*, para. 7.108. (footnote omitted)

<sup>294</sup>Appellate Body Report, *US – Gambling*, para. 308. (footnote omitted)

<sup>295</sup>See *supra*, para. 119.

<sup>296</sup>Appellate Body Report, *US – Gambling*, para. 308.

<sup>297</sup>The Panel noted that Brazil has already implemented or is in the process of implementing measures to encourage domestic retreading or improve the retreadability of tyres. (Panel Report, para. 7.169) The Panel observed that "imports of used tyres are already prohibited" (*Ibid.*, para. 7.171 (original emphasis)) The Panel agreed with Brazil that "collection and disposal schemes such as Resolution CONAMA 258/1999 as amended [in 2002] and Paraná Rodando Limpo have already been implemented in Brazil". (*Ibid.*, para. 7.178)

Import Ban components of Brazil's policy regarding waste tyres that are complementary to the Import Ban.

173. We move now to the other measures or practices proposed by the European Communities as alternatives to the Import Ban.<sup>298</sup> The European Communities contends that the Panel committed an error of law by applying a "narrow definition of alternative"<sup>299</sup>, according to which an alternative to the Import Ban is "a measure that must avoid the waste tyres arising specifically from imported retreaded tyres"<sup>300</sup>, or one "equal to a waste non-generation measure".<sup>301</sup> For the European Communities, this narrow definition differs from "the objective allegedly pursued by the challenged measure"<sup>302</sup>, and resulted in the rejection of several disposal and waste management measures presented by the European Communities that should have been accepted as alternatives to the Import Ban.

174. In evaluating whether the measures or practices proposed by the European Communities were "alternatives", the Panel sought to determine whether they would achieve Brazil's policy objective and chosen level of protection<sup>303</sup>, that is to say, reducing the "exposure to the risks to human, animal or plant life or health arising from the accumulation of waste tyres"<sup>304</sup> to the maximum extent possible.<sup>305</sup> In this respect, we believe, like the Panel, that non-generation measures are more apt to achieve this objective because they prevent the accumulation of waste tyres, while waste management measures dispose of waste tyres only once they have accumulated. Furthermore, we note that, in comparing a proposed alternative to the Import Ban, the Panel took into account specific risks attached to the proposed alternative, such as the risk of leaching of toxic substances that might be associated to landfilling<sup>306</sup>, or the risk of toxic emissions that might arise from the incineration of waste tyres.<sup>307</sup> In our view, the Panel did not err in so doing. Indeed, we do not see how a panel

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<sup>298</sup>These measures or practices are the following disposal methods: landfilling; stockpiling; incineration of waste tyres; and material recycling.

<sup>299</sup>European Communities' appellant's submission, para. 227.

<sup>300</sup>*Ibid.*, para. 219. (underlining omitted)

<sup>301</sup>*Ibid.*, para. 222.

<sup>302</sup>*Ibid.*, para. 221.

<sup>303</sup>Panel Report, para. 7.157.

<sup>304</sup>*Ibid.*, para. 7.102.

<sup>305</sup>*Ibid.*, para. 7.108. (footnote omitted) See also *ibid.*, para. 7.152:

We must therefore now consider whether any alternative measure, less inconsistent with GATT 1994, that is, less trade-restrictive than a complete import ban, would have been reasonably available to Brazil to achieve the same objective, taking into account Brazil's chosen level of protection. (footnote omitted)

<sup>306</sup>*Ibid.*, para. 7.183.

<sup>307</sup>*Ibid.*, para. 7.194.

could undertake a meaningful comparison of the measure at issue with a possible alternative while disregarding the risks arising out of the implementation of the possible alternative.<sup>308</sup> In this case, the Panel examined as proposed alternatives landfilling, stockpiling, and waste tyre incineration, and considered that, even if these disposal methods were performed under controlled conditions, they nevertheless pose risks to human health similar or additional to those Brazil seeks to reduce through the Import Ban.<sup>309</sup> Because these practices carry their own risks, and these risks do not arise from non-generation measures such as the Import Ban, we believe, like the Panel, that these practices are not reasonably available alternatives.

175. With respect to material recycling, we share the Panel's view that this practice is not as effective as the Import Ban in reducing the exposure to the risks arising from the accumulation of waste tyres. Material recycling applications are costly, and hence capable of disposing of only a limited number of waste tyres.<sup>310</sup> We also note that some of them might require advanced technologies and know-how that are not readily available on a large scale. Accordingly, we are of the view that the Panel did not err in concluding that material recycling is not a reasonably available alternative to the Import Ban.

### 3. The Weighing and Balancing of Relevant Factors by the Panel

176. The European Communities argues that, in its analysis of the necessity of the Import Ban, the Panel stated that it had weighed and balanced the relevant factors, but it "has not actually done it".<sup>311</sup> According to the European Communities, although the Appellate Body has not defined the term "weighing and balancing", "this language refers clearly to a process where, in the first place, the importance of each element is assessed individually and, then, its role and relative importance is taken into consideration together with the other elements for the purposes of deciding whether the challenged measure is necessary to attain the objective pursued."<sup>312</sup> The European Communities reasons that, "since the Panel failed to establish ... the extent of the actual contribution the [Import Ban] makes to the reduction of the number of waste tyres arising in Brazil, ... it was incapable of 'weighing and balancing' this contribution against any of the other relevant factors."<sup>313</sup> In addition,

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<sup>308</sup>This was recognized by the Appellate Body in *EC – Asbestos*, where it stated that the risks attached to a proposed measure should be included in the exercise of comparison aiming to determine whether it is a reasonably available alternative to the measure at issue. (Appellate Body Report, *EC – Asbestos*, para. 174)

<sup>309</sup>Panel Report, para. 7.195; see also para. 7.186 (landfilling); para. 7.189 (stockpiling); and para. 7.194 (waste tyre incineration).

<sup>310</sup>*Ibid.*, paras. 7.201 and 7.205-7.208.

<sup>311</sup>European Communities' appellant's submission, para. 285.

<sup>312</sup>*Ibid.*, para. 284.

<sup>313</sup>*Ibid.*, para. 288.

the European Communities contends that "the Panel base[d] ... its 'weighing and balancing' exercise on the wrong analysis it ... made of the alternatives".<sup>314</sup> In sum, the European Communities argues that the Panel conducted a "superficial analysis"<sup>315</sup> that is not a real weighing and balancing of the different factors and alternatives, because it did not balance "its arguments about the measure and the alternatives with the absolute trade-restrictiveness of the import ban and with a real evaluation of the contribution of the import ban to the objective pursued."<sup>316</sup>

177. Brazil counters that the Panel correctly weighed and balanced the relevant factors and proposed alternatives in its necessity analysis. Brazil argues that the Panel expressly recognized that the Import Ban is highly trade restrictive, but properly weighed and balanced this factor against the other relevant factors. In relation to contribution, Brazil considers that Article XX(b) of the GATT 1994 does not require quantification, and that, in any event, the Import Ban's contribution to the reduction of imports of retreaded tyres is "substantial".<sup>317</sup> Brazil adds that, because imports of retreaded tyres by definition increase the amount of waste tyres in Brazil, the contribution of the Import Ban to the reduction of risks arising from waste tyres to the maximum extent possible is "both direct and certain".<sup>318</sup>

178. We begin our analysis by recalling that, in order to determine whether a measure is "necessary" within the meaning of Article XX(b) of the GATT 1994, a panel must consider the relevant factors, particularly the importance of the interests or values at stake, the extent of the contribution to the achievement of the measure's objective, and its trade restrictiveness. If this analysis yields a preliminary conclusion that the measure is necessary, this result must be confirmed by comparing the measure with possible alternatives, which may be less trade restrictive while providing an equivalent contribution to the achievement of the objective. This comparison should be carried out in the light of the importance of the interests or values at stake.<sup>319</sup> It is through this process that a panel determines whether a measure is necessary.<sup>320</sup>

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<sup>314</sup>European Communities' appellant's submission, para. 290. (underlining omitted)

<sup>315</sup>*Ibid.*, para. 295.

<sup>316</sup>*Ibid.*, para. 294.

<sup>317</sup>Brazil's appellee's submission, para. 177.

<sup>318</sup>*Ibid.*, para. 178.

<sup>319</sup>Appellate Body Report, *US – Gambling*, para. 307.

<sup>320</sup>*Ibid.*

179. In this case, the Panel identified the objective of the Import Ban as being the reduction of the exposure to risks arising from the accumulation of waste tyres. It assessed the importance of the interests underlying this objective. It found that risks of dengue fever and malaria arise from the accumulation of waste tyres and that the objective of protecting human life and health against such diseases "is both vital and important in the highest degree".<sup>321</sup> The Panel noted that the objective of the Import Ban also relates to the protection of the environment, a value that it considered—correctly, in our view—important.<sup>322</sup> Then, the Panel analyzed the trade restrictiveness of the Import Ban and its contribution to the achievement of its objective. It appears from the Panel's reasoning that it considered that, in the light of the importance of the interests protected by the objective of the Import Ban, the contribution of the Import Ban to the achievement of its objective outweighs its trade restrictiveness. This finding of the Panel does not appear erroneous to us.<sup>323</sup>

180. The Panel then proceeded to examine the alternatives to the Import Ban proposed by the European Communities. The Panel explained that some of them could not be viewed as alternatives to the Import Ban because they were complementary to it and were already included in Brazil's comprehensive policy.<sup>324</sup> Next, the Panel compared the other alternatives proposed by the European Communities—landfilling, stockpiling, incineration, and material recycling—with the Import Ban, taking into consideration the specific risks associated with these proposed alternatives. The Panel concluded from this comparative assessment that none of the proposed options was a reasonably available alternative to the Import Ban.

181. The European Communities argues that the Panel failed to make a proper collective assessment of all the proposed alternatives, a contention that does not stand for the following reasons. First, the Panel did refer to its collective examination of these alternatives in concluding that "none of these, either individually or collectively, would be such that the risks arising from waste tyres in Brazil would be safely eliminated, as is intended by the current import ban."<sup>325</sup> Secondly, as noted by

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<sup>321</sup>Panel Report, para. 7.210. (footnote omitted)

<sup>322</sup>*Ibid.*, para. 7.112.

<sup>323</sup>*Supra*, paras. 150-155.

<sup>324</sup>For example, measures to encourage domestic retreading and improve the retreadability of domestic used tyres, a better implementation of the import ban on used tyres, and a better implementation of existing collection and disposal schemes. See also Panel Report, paras. 7.169, 7.171, and 7.178.

<sup>325</sup>*Ibid.*, para. 7.214. (emphasis added)

the Panel and discussed above, some of the proposed alternatives are not real substitutes for the Import Ban since they complement each other as part of Brazil's comprehensive policy.<sup>326</sup> Finally, having found that other proposed alternatives were not reasonably available or carried their own risks, these alternatives would not have weighed differently in a collective assessment of alternatives.

182. In sum, the Panel's conclusion that the Import Ban is necessary was the result of a process involving, first, the examination of the contribution of the Import Ban to the achievement of its objective against its trade restrictiveness in the light of the interests at stake, and, secondly, the comparison of the possible alternatives, including associated risks, with the Import Ban. The analytical process followed by the Panel is consistent with the approach previously defined by the Appellate Body.<sup>327</sup> The weighing and balancing is a holistic operation that involves putting all the variables of the equation together and evaluating them in relation to each other after having examined them individually, in order to reach an overall judgement. We therefore do not share the European Communities' view that the Panel did not "actually" weigh and balance the relevant factors<sup>328</sup>, or that the Panel made a methodological error in comparing the alternative options proposed by the European Communities with the Import Ban.

183. In the light of all these considerations, we are of the view that the Panel did not err in the manner it conducted its analysis under Article XX(b) of the GATT 1994 as to whether the Import Ban was "necessary to protect human, animal or plant life or health".

#### B. *The Panel's Necessity Analysis and Article 11 of the DSU*

184. The European Communities claims that the Panel breached its duties under Article 11 of the DSU in its analysis of the "necessity" of the Import Ban under Article XX(b) of the GATT 1994. In particular, the European Communities submits that the Panel failed to make an objective assessment of the facts in its assessment of the contribution of the Import Ban to the achievement of its objective, and in its examination of the proposed alternatives.

<sup>326</sup>Panel Report, para. 7.213.

<sup>327</sup>Appellate Body Report, *Korea – Various Measures on Beef*, para. 164; Appellate Body Report, *EC – Asbestos*, para. 172; Appellate Body Report, *US – Gambling*, para. 306; Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 70.

<sup>328</sup>European Communities' appellant's submission, para. 285.

#### 1. Article 11 of the DSU and the Panel's Analysis of the Contribution of the Import Ban to the Achievement of Its Objective

185. We recall that Article 11 requires a panel to conduct "an objective assessment of the matter before it, including an objective assessment of the facts of the case". This assessment implies, among other things, that a panel must consider all the evidence presented to it, assess its credibility, determine its weight, and ensure that its factual findings have a proper basis in that evidence.<sup>329</sup>

186. Within these parameters, it is generally "within the discretion of the panel to decide which evidence it chooses to utilize in making findings"<sup>330</sup>, and panels are "not required to accord to factual evidence of the parties the same meaning and weight as do the parties".<sup>331</sup> A panel is entitled "to determine that certain elements of evidence should be accorded more weight than other elements—that is the essence of the task of appreciating the evidence"<sup>332</sup>—and the Appellate Body "will not interfere lightly with the panel's exercise of its discretion".<sup>333</sup> Thus, a participant challenging a panel's findings of fact under Article 11 of the DSU is required to demonstrate that the panel has exceeded the bounds of its discretion as the trier of facts.

187. Against this background, we turn to the contentions of the European Communities. First, the European Communities argues that there was an insufficient factual foundation for the Panel's conclusion that it had "no reason to believe that new tyres sold in Brazil are low-quality tyres" that were not capable of being retreaded<sup>334</sup>, and that the Panel ignored "substantial evidence" produced by the European Communities demonstrating the existence of "low-quality non-retreadable tyres"<sup>335</sup> in the Brazilian market.

<sup>329</sup>Appellate Body Report, *EC – Hormones*, paras. 132 and 133. See also Appellate Body Report, *Japan – Apples*, para. 221; Appellate Body Report, *EC – Asbestos*, para. 161; Appellate Body Report, *Australia – Salmon*, para. 266; Appellate Body Report, *EC – Bed Linen (Article 21.5 – India)*, paras. 170, 177, and 181; Appellate Body Report, *EC – Sardines*, para. 299; Appellate Body Report, *EC – Tube or Pipe Fittings*, para. 125; Appellate Body Report, *Japan – Agricultural Products II*, paras. 141 and 142; Appellate Body Report, *Korea – Dairy*, para. 138; Appellate Body Report, *Korea – Alcoholic Beverages*, paras. 161 and 162; Appellate Body Report, *US – Oil Country Tubular Goods Sunset Reviews*, para. 313; Appellate Body Report, *US – Gambling*, para. 363; Appellate Body Report, *EC – Selected Customs Matters*, para. 258; and Appellate Body Report, *US – Carbon Steel*, para. 142.

<sup>330</sup>Appellate Body Report, *US – Carbon Steel*, para. 142 (quoting Appellate Body Report, *EC – Hormones*, para. 135).

<sup>331</sup>Appellate Body Report, *Australia – Salmon*, para. 267.

<sup>332</sup>Appellate Body Report, *EC – Asbestos*, para. 161.

<sup>333</sup>Appellate Body Report, *US – Wheat Gluten*, para. 151. (footnote omitted)

<sup>334</sup>Panel Report, para. 7.137; European Communities' appellant's submission, paras. 183 and 184.

<sup>335</sup>European Communities' appellant's submission, para. 183. (footnote omitted)

188. Brazil submits that the Panel's conclusion is supported by the evidence on record and adds that high rates of retreadability in the country demonstrate that new tyres sold in Brazil "generally have [the] potential for future retreading".<sup>336</sup>

189. We observe that, in support of its position that it had "no reason to believe that new tyres sold in Brazil are low-quality tyres" that are not suitable for retreading, the Panel referred to standards applied to new tyres sold in Brazil that are "strict technical and performance standards that are based on international standards".<sup>337</sup> The European Communities argues that potential retreadability is not an element of these standards and that, therefore, the Panel's position on the retreadability of new tyres sold in Brazil had no factual basis.<sup>338</sup> We are not persuaded by this argument. The Panel's position was not that these standards include retreadability but, rather, that they result in a level of quality for new tyres that increases the potential for them to be retreaded.<sup>339</sup> Thus, the Panel's finding did not lack a factual basis since there was a relationship between the standards to which the Panel referred and its conclusion that it had "no reason to believe that new tyres sold in Brazil are low-quality tyres"<sup>340</sup> that are not retreadable.

190. Nor did the Panel disregard the evidence presented by the European Communities in reaching its conclusion on retreadability. To the contrary, the Panel expressly referred to various studies submitted by the European Communities in Exhibits EC-15 and EC-67 through EC-71, which related to the existence of "cheap low-quality new tyres in Brazil".<sup>341</sup> The Panel simply attached more weight to other pieces of evidence that were before it<sup>342</sup>, as Article 11 of the DSU entitles it to do.<sup>343</sup>

191. The European Communities asserts further that the Panel relied on "arbitrarily chosen pieces of evidence" and failed to consider contradictory evidence<sup>344</sup> in basing its finding that "at least some domestic used tyres are being retreaded in Brazil"<sup>345</sup> exclusively on a statement contained in a report by the Associação Brasileira do Segmento de Reforma de Pneus (the "ABR") (Brazilian Association

<sup>336</sup>Brazil's appellee's submission, para. 116.

<sup>337</sup>Panel Report, para. 7.137.

<sup>338</sup>European Communities' appellant's submission, para. 184.

<sup>339</sup>Panel Report, para. 7.137.

<sup>340</sup>*Ibid.*

<sup>341</sup>*Ibid.*, footnote 1252 to para. 7.137 (referring to European Communities' oral statement at the first Panel meeting, para. 28; and European Communities' response to Question 11 posed by the Panel, Panel Report, pp. 254 and 255, in turn referring to Exhibits EC-15 and EC-67 through EC-71 submitted by the European Communities to the Panel).

<sup>342</sup>*Ibid.*, para. 7.137.

<sup>343</sup>Appellate Body Report, *EC – Asbestos*, para. 161.

<sup>344</sup>European Communities' appellant's submission, para. 185.

<sup>345</sup>Panel Report, para. 7.136.

of the Retreading Industry) (the "ABR Report").<sup>346</sup> According to the European Communities, the Panel neglected to consider evidence contained in a second report by the ABR<sup>347</sup> that contradicted this statement.<sup>348</sup> We do not find merit in this argument. The Panel relied on various studies and reports other than the ABR Report.<sup>349</sup> Moreover, the Panel took into account the evidence in the second report by the ABR<sup>350</sup> as the express reference it made to that report confirms.<sup>351</sup>

192. The European Communities next charges the Panel with failing to discount the evidentiary value of Technical Note 001/2006 of the Instituto Nacional de Metrologia, Normalização e Qualidade Industrial ("INMETRO") (National Institute for Metrology, Standardization and Industrial Quality)<sup>352</sup>, on the grounds that it was issued during the course of the Panel proceedings, and with neglecting to consider contradictory evidence contained in an earlier INMETRO Technical Note 83/2000.<sup>353</sup>

193. It is well settled that a panel may consider a piece of evidence that post-dates its establishment.<sup>354</sup> Thus, INMETRO Technical Note 001/2006 was clearly an admissible piece of evidence. The European Communities, however, seems to suggest that the fact that INMETRO Technical Note 001/2006 post-dates the establishment of the Panel undermines its "evidentiary value", because Brazil was well aware of the significance of INMETRO Technical Note 001/2006 at that time. In our view, this amounts to an argument that the Panel should have attached more weight to one piece of evidence than to another, and does not suffice to demonstrate that the Panel exceeded the bounds of its discretion by attaching more weight to INMETRO Technical Note 001/2006—a

<sup>346</sup>*Supra*, footnote 41.

<sup>347</sup>*Supra*, footnote 43.

<sup>348</sup>European Communities' appellant's submission, paras. 186 and 187.

<sup>349</sup>For example, the Panel relied on, *inter alia*, retreadability figures for the Brazilian company Mazola Comércio (Panel Report, para. 7.135 and footnote 1236 thereto (referring to Exhibit BRA-93 submitted by Brazil to the Panel)); studies by the consultancy LAFIS and the Institute of Technological Research of the State of São Paulo (*ibid.*, footnote 1237 (referring to Exhibits EC-92 and BRA-159 submitted by the European Communities and Brazil, respectively, to the Panel)); a video by BS Colway (*ibid.*, footnote 1239 (referring to Exhibit EC-72 submitted by the European Communities to the Panel)); and retreadability figures in Brazil (*ibid.*, footnote 1241 (referring to Brazil's oral statement at the second Panel meeting, paras. 57-61; Brazil's comments on Question 107 posed by the Panel to the European Communities, Panel Report, pp. 317-323; Brazil's response to Question 117 posed by the Panel, Panel Report, pp. 332-334; and Exhibit BRA-162 submitted by Brazil to the Panel)) and in other countries (*ibid.*, footnote 1242 (referring to Brazil's first written submission to the Panel, para. 79, where Brazil provided some examples of retreadability figures for the United Kingdom, the United States, Australia, and France)). See also Brazil's response to Question 17 posed by the Panel, *ibid.*, p. 257.

<sup>350</sup>Exhibit BRA-157, *supra*, footnote 43.

<sup>351</sup>See Panel Report, footnote 1238 to para. 7.135 (referring to Exhibit BRA-157, *supra*, footnote 43).

<sup>352</sup>Exhibit BRA-163 submitted by Brazil to the Panel.

<sup>353</sup>European Communities' appellant's submission, paras. 188 and 189 (referring to INMETRO Technical Note 83/2000 (Exhibit EC-45 submitted by the European Communities to the Panel)).

<sup>354</sup>This was confirmed by the Appellate Body in its Report, *EC – Selected Customs Matters*, at para. 188.

more recent document—than to INMETRO Technical Note 83/2000. Furthermore, the Panel did not neglect INMETRO Technical Note 83/2000. As the European Communities acknowledges<sup>355</sup>, the Panel expressly referred to this particular piece of evidence in its analysis.<sup>356</sup>

194. The European Communities further maintains that the Panel ignored evidence contained in a study by the consultancy LAFIS<sup>357</sup> indicating that the rate of retreading of passenger car tyres in Brazil is below 9.99 per cent.<sup>358</sup> The Panel, however, specifically considered the LAFIS study in its analysis as to whether domestic used tyres are retreadable and are being retreaded in Brazil.<sup>359</sup> It also discussed the arguments presented by Brazil and the European Communities in relation to this figure.

195. The European Communities charges the Panel with "bolster[ing] its conclusions"<sup>360</sup> on the retreadability of domestic casings with speculation on future measures that Brazil may take and, in particular, in stating that "mandatory inspections are taking place in Brazil and that more frequent inspections are to be expected once Bill 5979/2001 is approved".<sup>361</sup> However, the Panel's finding that "mandatory inspections are taking place"<sup>362</sup> was based on inspection requirements imposed by Brazil's National Code of Traffic and applicable technical standards, which were in force at the time the Panel conducted its review<sup>363</sup>, and is not vitiated by the Panel's additional reference to possible consequences of the approval of Bill 5979/2001.

196. In addition, the European Communities contends that, in analyzing the contribution of the Import Ban to the realization of the ends pursued by it, the Panel erred in failing to accord any evidentiary weight to the fact that Brazilian retreaders have sought court injunctions that permit the importation of used tyres for further retreading.<sup>364</sup> The European Communities claims that the Panel engaged in a "wilful exclusion"<sup>365</sup> of evidence relating to the importation of used tyres through court injunctions, even though this evidence was relevant because it demonstrates that Brazilian retreaded

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<sup>355</sup>European Communities' appellant's submission, para. 189 and footnote 56 thereto.

<sup>356</sup>Panel Report, footnote 1240 to para. 7.135.

<sup>357</sup>European Communities' appellant's submission, para. 190 (referring to LAFIS report, *supra*, footnote 45, p. 11).

<sup>358</sup>*Ibid.*, para. 190.

<sup>359</sup>Panel Report, para. 7.135 and footnote 1237 thereto.

<sup>360</sup>European Communities' appellant's submission, para. 195.

<sup>361</sup>Panel Report, para. 7.138.

<sup>362</sup>*Ibid.*

<sup>363</sup>See *ibid.*, para. 7.138 (referring to Law No. 9.503 of 23 September 1997 (National Code of Traffic) (Exhibit BRA-102 submitted by Brazil to the Panel); and Brazil's response to Question 8 posed by the European Communities).

<sup>364</sup>European Communities' appellant's submission, para. 191.

<sup>365</sup>*Ibid.*, para. 192.

tyres are produced with imported casings, and casts doubt on Brazil's position that domestic casings suitable for retreading are readily available in Brazil.<sup>366</sup>

197. We are not persuaded that the Panel ignored evidence relating to the importation of used tyres through court injunctions in its analysis of the contribution of the Import Ban to the realization of the ends pursued by it. The Panel acknowledged these injunctions and the arguments put forth by the European Communities in its analysis of the conflicting arguments and evidence regarding the level of retreadability of tyres in Brazil.<sup>367</sup> In the end, the Panel ascribed more weight to evidence adduced by Brazil suggesting that "at least some domestic used tyres are being retreaded in Brazil"<sup>368</sup> and that "domestic used tyres are suitable for retreading".<sup>369</sup> It appears to us that, in proceeding in that manner, the Panel did not exceed the bounds of its discretion as the trier of facts.

198. In the light of the above considerations, we *find* that the Panel did not fail to conduct an objective assessment of the facts of the case, as required by Article 11 of the DSU, when evaluating the contribution of the Import Ban to the achievement of its objective.

## 2. Article 11 of the DSU and the Panel's Examination of Possible Alternatives to the Import Ban

199. The European Communities contends that, in its analysis of possible alternatives to the Import Ban, the Panel did not make an objective assessment of the facts as required by Article 11 of the DSU. The European Communities' claim of error under Article 11 is directed at the Panel's appreciation of the evidence concerning a number of disposal methods for waste tyres suggested by the European Communities as alternatives to the Import Ban, namely, landfilling, controlled stockpiling, co-incineration, and material recycling.

200. According to the European Communities, the Panel's factual findings in relation to each of these alternatives were not based on an objective assessment, because the Panel ignored important facts and arguments submitted by the European Communities and referred to the evidence before it "in a selective and distorted manner".<sup>370</sup> The European Communities also charges the Panel with failing to consider one specific alternative to the Import Ban suggested by the European Communities, namely, the National Dengue Control Programme.<sup>371</sup>

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<sup>366</sup>European Communities' appellant's submission, paras. 192 and 193.

<sup>367</sup>Panel Report, para. 7.140.

<sup>368</sup>*Ibid.*, para. 7.136.

<sup>369</sup>*Ibid.*, para. 7.142.

<sup>370</sup>European Communities' appellant's submission, para. 247.

<sup>371</sup>*Supra*, footnote 53.

201. Regarding the landfilling of waste tyres, the Panel reviewed the extensive evidentiary record on the risks posed by landfills of waste tyres.<sup>372</sup> In the course of its analysis of this evidence, the Panel noted the distinction made by the European Communities between "uncontrolled" and "controlled" landfills<sup>373</sup>, but observed that "the evidence on the health and environmental risks posed by landfills of waste tyres does not make a clear distinction between 'uncontrolled' and the so-called 'controlled' landfills"<sup>374</sup>, and that its assessment of that evidence indicated that "it [was] not possible to conclude that controlled landfills do not pose risks similar to those linked to other types of waste tyre landfills."<sup>375</sup> Therefore, contrary to the European Communities' assertion that the Panel erred in basing its findings exclusively on evidence relating to uncontrolled landfilling, the Panel's conclusion that landfilling "may pose the very risks Brazil seeks to avoid through the import ban"<sup>376</sup> was based on evidence that demonstrates that risks arise indistinctively from controlled and uncontrolled landfills.

202. The European Communities also suggests that the Panel erred under Article 11 in its rejection of landfilling as an alternative to the Import Ban because it did not take into account legislation allowing some landfilling of shredded tyres in Brazil. It is true that the Panel did not refer specifically to this legislation in its analysis. We note, however, that Brazil had argued that the legislation in question was exceptional, temporary, and in no way contradicted the existence or risks generally associated with landfilling.<sup>377</sup> A panel enjoys discretion in assessing whether a given piece of evidence is relevant for its reasoning<sup>378</sup>, and is not required to discuss, in its report, each and every piece of evidence.<sup>379</sup>

203. We turn to the European Communities' argument that the Panel did not objectively assess the facts in observing that "stockpiling as such does not 'dispose of' waste tyres" and that controlled stockpiling "may still pose considerable risks to human health and the environment".<sup>380</sup> The Panel did not, as the European Communities contends, erroneously treat stockpiling as a "final disposal

<sup>372</sup>Panel Report, para. 7.183 and footnotes 1318 and 1319 thereto (referring to Exhibits BRA-1, BRA-8, BRA-38, BRA-41, BRA-45, and BRA-58 submitted by Brazil to the Panel).

<sup>373</sup>*Ibid.*, para. 7.184.

<sup>374</sup>*Ibid.*

<sup>375</sup>*Ibid.* In particular, we observe that the evidence relating to the risk of tyre fires and to the long-term leaching of toxic chemicals referred to in paragraph 7.183 and footnote 1318 thereto of the Panel Report does not appear to distinguish between landfilling of whole tyres and landfilling of shredded tyres.

<sup>376</sup>*Ibid.*, para. 7.186.

<sup>377</sup>Brazil's appellee's submission, para. 152.

<sup>378</sup>See Appellate Body Report, *EC – Hormones*, para. 132.

<sup>379</sup>See Appellate Body Report, *Chile – Price Band System (Article 21.5 – Argentina)*, para. 240; see also Appellate Body Report, *EC – Hormones*, para. 138.

<sup>380</sup>Panel Report, para. 7.188. (footnote omitted)

operation".<sup>381</sup> To the contrary, the Panel recognized that stockpiling is used only for temporary storage.<sup>382</sup> Moreover, the Panel's finding that stockpiling, even as an intermediate operation, carries risks of its own rested on various pieces of evidence, including a California Environmental Protection Agency study that concludes, in relation to controlled stockpiling, that "[a]ll tire and rubber storage facilities should be considered high-risk storage facilities."<sup>383</sup>

204. Regarding co-incineration, the Panel found that "Brazil has provided sufficient evidence to demonstrate that health risks exist in relation to the incineration of waste tyres, even if such risks can be significantly reduced through strict emission standards."<sup>384</sup> In reaching this conclusion, the Panel relied on evidence consisting of technical studies and reports of regulatory agencies relating to activities in countries other than Brazil.<sup>385</sup> The Panel acted within its margin of discretion as the trier of facts in considering that evidence relating to co-incineration activities in countries other than Brazil was relevant to the question of whether co-incineration poses health risks if used in Brazil, and in relying on that evidence.

205. With respect to material recycling applications such as civil engineering, rubber asphalt, rubber products, and devulcanization, the Panel found that it is not clear that they "are entirely safe"<sup>386</sup>, and that even if they were, material recycling applications "would not be able to dispose of a quantity of waste tyres sufficient to achieve Brazil's desired level of protection due to their prohibitive costs".<sup>387</sup> The European Communities contends that both of these findings lacked a proper factual foundation.

<sup>381</sup>European Communities' appellant's submission, para. 255.

<sup>382</sup>Panel Report, footnote 1330 to para. 7.188. The Panel referred to the *Basel Convention Technical Guidelines on the Identification and Management of Used Tyres* (1999) (Exhibit BRA-40 submitted by Brazil to the Panel), p. 12, which states, *inter alia*, that "[s]tockpiling with proper control can be used only for temporary storage before an end-of-life tyre is forwarded to a recovery operation."

<sup>383</sup>Panel Report, para. 7.189 and footnote 1331 thereto (referring to California Environmental Protection Agency (US), Integrated Waste Management Board, "Tire Pile Fires: Prevention, Response, Remediation" (2002) (Exhibit BRA-29 submitted by Brazil to the Panel)).

<sup>384</sup>*Ibid.*, para. 7.194.

<sup>385</sup>*Ibid.*, para. 7.192 and footnotes 1339-1342 thereto. In particular, the Panel referred to a report which concluded that "emissions of toxic organics ... [as a result of co-incineration of waste tyres] cannot be effectively controlled." (*Ibid.*, footnote 1339 (quoting Okopol Institut für Ökologie und Politik GmbH, "Expertise on the Environmental Risk Associated with the Co-Incineration of Wastes in the Cement Kiln Four E' of CBR Usine de Lixhe, Belgium" (circa 1998) (Exhibit BRA-46 submitted by Brazil to the Panel)). The Panel also pointed to evidence that demonstrated that "there is no scientific basis for [concluding] that burning waste tyres in cement kilns is safe" (*Ibid.* (quoting letter from Seymour I. Schwartz to the California Integrated Waste Management Board, dated 21 January 1998 (Exhibit BRA-49 submitted by Brazil to the Panel)), and that "[u]se [of waste tyres] in wet cement kilns is not an optimal environmental solution" (*ibid.* (quoting European Environment Agency, "Waste from road vehicles" (2001) (Exhibit BRA-108 submitted by Brazil to the Panel)).

<sup>386</sup>*Ibid.*, para. 7.208.

<sup>387</sup>*Ibid.*

206. The Panel stated that "*it is not clear* whether some of these engineering applications are sufficiently safe."<sup>388</sup> It also expressed the view that "the evidence is *inconclusive* on whether rubber asphalt exposures are more hazardous than conventional asphalt exposures."<sup>389</sup> Furthermore, the Panel did "not find evidence showing that devulcanization or other forms of chemical or thermal transformation such as pyrolysis pose substantial health or environmental risks."<sup>390</sup> It is on the basis of these findings that the Panel concluded that "*it is not clear* that material recycling applications are entirely safe."<sup>391</sup> The Panel relied on numerous pieces of evidence to make these findings<sup>392</sup>, and the European Communities has not demonstrated that this evidence cannot support the Panel's finding. Moreover, in finding that material recycling was not a reasonably available alternative to the Import Ban, the Panel relied mainly on the limited disposal capacity of these applications; safety considerations were not central to its reasoning.

207. Indeed, the Panel determined that evidence adduced in relation to civil engineering<sup>393</sup>, rubber asphalt<sup>394</sup>, rubber products<sup>395</sup>, and devulcanization<sup>396</sup> suggested that each of these applications involve high costs that would significantly limit their ability "to dispose of a quantity of waste tyres sufficient to achieve Brazil's desired level of protection"<sup>397</sup>. The European Communities argues that the Panel erred in rejecting material recycling applications on the basis of their costs<sup>398</sup>, suggesting that the Panel erroneously equated *high* costs with *prohibitive* costs, when only the latter would justify a finding that a given alternative is not "reasonably available". This argument is based on an artificial

<sup>388</sup>Panel Report, para. 7.202. (emphasis added)

<sup>389</sup>*Ibid.*, para. 7.205. (footnote omitted; emphasis added)

<sup>390</sup>*Ibid.*, para. 7.207.

<sup>391</sup>*Ibid.*, para. 7.208. (emphasis added)

<sup>392</sup>*Ibid.*, para. 7.202 and footnote 1359 thereto.

<sup>393</sup>*Ibid.*, para. 7.201 and footnote 1358 thereto (referring to the European Tyre and Rubber Manufacturers' Association (Exhibit EC-84 submitted by the European Communities to the Panel); California Environmental Protection Agency (US), Integrated Waste Management Board, "Five-Year Plan for the Waste Tyre Recycling Management Program" (2003) (Exhibit BRA-36 submitted by Brazil to the Panel); and K. Cannon, "Environment: Where Mosquitoes And Tires Breed", *The New York Times*, 8 July 2001 (Exhibit BRA-130 submitted by Brazil to the Panel)).

<sup>394</sup>*Ibid.*, para. 7.205 and footnote 1367 thereto (referring to OECD Report, *supra*, footnote 52).

<sup>395</sup>*Ibid.*, para. 7.206 and footnote 1368 thereto (referring to J. Serungard, "Internalization of Scrap Tyre Management Costs: A Review of the North American Experience", in Proceedings of the Second Joint Workshop of the Secretariat of the United Nations Conference on Trade and Development (UNCTAD) and the International Rubber Study Group on Rubber and the Environment (1998) (Exhibit BRA-125 submitted by Brazil to the Panel); and Human Resources and Social Development Canada, Rubber Industry (circa 1999) (Exhibit BRA-131 submitted by Brazil to the Panel)).

<sup>396</sup>*Ibid.*, para. 7.207 and footnote 1371 thereto (referring to Exhibits EC-15 and EC-18 submitted by the European Communities to the Panel; and Exhibit BRA-125 submitted by Brazil to the Panel).

<sup>397</sup>*Ibid.*, para. 7.208.

<sup>398</sup>European Communities' appellant's submission, para. 278.

distinction between high and prohibitive costs. Further, in our view, this is not an issue relating to the Panel's appreciation of the evidence, but rather to its legal characterization of the facts. In any event, what disqualifies these alternatives, according to the Panel, is not their high costs as such, but the effect of these high costs in limiting the disposal capacity of these methods.

208. Finally, the European Communities claims that the Panel failed to analyze as a possible alternative measure the National Dengue Control Programme, and that this failure constitutes a violation of Article 11 of the DSU.<sup>399</sup> We observe that the European Communities referred to the National Dengue Control Programme in its second written submission to the Panel in support of its contention that "authorities in Brazil seem to encourage material recycling as an alternative."<sup>400</sup> We note further that the alternative measure identified there was material recycling, and that the National Dengue Control Programme was discussed under the subheading "Material recycling" in the European Communities' written submission merely as one example of material recycling.<sup>401</sup> Thus, the National Dengue Control Programme was not submitted by the European Communities as a distinct alternative measure but, rather, was presented as an illustration of material recycling, which the Panel discussed extensively.

209. Accordingly, we *find* that the Panel did not fail to conduct an objective assessment of the facts, as required by Article 11 of the DSU, in finding that the disposal methods for waste tyres suggested by the European Communities were not reasonably available alternatives to the Import Ban.

### C. General Conclusion on the Necessity Analysis under Article XX(b) of the GATT 1994

210. At this stage, it may be useful to recapitulate our views on the issue of whether the Import Ban is necessary within the meaning of Article XX(b) of the GATT 1994. This issue illustrates the tensions that may exist between, on the one hand, international trade and, on the other hand, public health and environmental concerns arising from the handling of waste generated by a product at the end of its useful life. In this respect, the fundamental principle is the right that WTO Members have to determine the level of protection that they consider appropriate in a given context. Another key element of the analysis of the necessity of a measure under Article XX(b) is the contribution it brings to the achievement of its objective. A contribution exists when there is a genuine relationship of ends and means between the objective pursued and the measure at issue. To be characterized as necessary, a measure does not have to be indispensable. However, its contribution to the achievement of the objective must be material, not merely marginal or insignificant, especially if the measure at issue is

<sup>399</sup>European Communities' appellant's submission, para. 280.

<sup>400</sup>European Communities' second written submission to the Panel, para. 137.

<sup>401</sup>See *Ibid.*, para. 138 under subheading II.A.4(c) iv) "Material recycling", p. 41.

as trade restrictive as an import ban. Thus, the contribution of the measure has to be weighed against its trade restrictiveness, taking into account the importance of the interests or the values underlying the objective pursued by it. As a key component of a comprehensive policy aiming to reduce the risks arising from the accumulation of waste tyres, the Import Ban produces such a material contribution to the realization of its objective. Like the Panel, we consider that this contribution is sufficient to conclude that the Import Ban is necessary, in the absence of reasonably available alternatives.

211. The European Communities proposed a series of alternatives to the Import Ban. Whereas the Import Ban is a preventive non-generation measure, most of the proposed alternatives are waste management and disposal measures that are remedial in character. We consider that measures to encourage domestic retreading or to improve the retreadability of tyres, a better enforcement of the import ban on used tyres, and a better implementation of existing collection and disposal schemes, are complementary to the Import Ban; indeed, they constitute mutually supportive elements of a comprehensive policy to deal with waste tyres. Therefore, these measures cannot be considered real alternatives to the Import Ban. As regards landfilling, stockpiling, co-incineration of waste tyres, and material recycling, these remedial methods carry their own risks or, because of the costs involved, are capable of disposing of only a limited number of waste tyres. The Panel did not err in concluding that the proposed measures or practices are not reasonably available alternatives.

212. Accordingly, having already found that the Panel did not breach its duty under Article 11 of the DSU, and in the light of the above considerations, we *uphold* the Panel's finding, in paragraph 7.215 of the Panel Report, that the Import Ban can be considered "necessary to protect human, animal or plant life or health."

## VI. The Panel's Interpretation and Application of the Chapeau of Article XX of the GATT 1994

### A. The MERCOSUR Exemption and the Chapeau of Article XX of the GATT 1994

213. After finding that the Import Ban was provisionally justified under Article XX(b) of the GATT 1994<sup>402</sup>, the Panel examined whether the application of the Import Ban by Brazil satisfied the requirements of the chapeau of Article XX.

214. The chapeau of Article XX of the GATT 1994 reads:

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 ... of measures [of the type specified in the subsequent paragraphs of Article XX].

215. The focus of the chapeau, by its express terms, is on the application of a measure already found to be inconsistent with an obligation of the GATT 1994 but falling within one of the paragraphs of Article XX.<sup>403</sup> The chapeau's requirements are two-fold. First, a measure provisionally justified under one of the paragraphs of Article XX must not be applied in a manner that would constitute "arbitrary or unjustifiable discrimination" between countries where the same conditions prevail. Secondly, this measure must not be applied in a manner that would constitute "a disguised restriction on international trade". Through these requirements, the chapeau serves to ensure that Members' rights to avail themselves of exceptions are exercised in good faith to protect interests considered legitimate under Article XX, not as a means to circumvent one Member's obligations towards other WTO Members.<sup>404</sup>

216. Having determined that the exemption from the Import Ban of remoulded tyres originating in MERCOSUR countries resulted in discrimination in the application of the Import Ban, the Panel examined whether this discrimination was arbitrary or unjustifiable. The Panel concluded that, as of the time of its examination, the operation of the MERCOSUR exemption had not resulted in the Import Ban being applied in a manner that would constitute "arbitrary or unjustifiable discrimination", within the meaning of the chapeau of Article XX.<sup>405</sup> The Panel also found that the MERCOSUR exemption had not been shown "to date" to result in the Import Ban being applied in a manner that would constitute "a disguised restriction on international trade", within the meaning of the chapeau of Article XX.<sup>406</sup> The European Communities appeals these findings of the Panel.

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<sup>403</sup> Appellate Body Report, *US – Gasoline*, p. 22, DSR 1996:1, 3, at 20; Appellate Body Report, *US – Gambling*, para. 339.

<sup>404</sup> Appellate Body Report, *US – Gasoline*, p. 22, DSR 1996:1, 3, at 20-21; Appellate Body Report, *US – Gambling*, para. 339.

<sup>405</sup> Panel Report, para. 7.289.

<sup>406</sup> *Ibid.*, paras. 7.354 and 7.355.

1. The MERCOSUR Exemption and Arbitrary or Unjustifiable Discrimination

217. Regarding the issue of whether the MERCOSUR exemption has resulted in the Import Ban being applied in a manner that would constitute "arbitrary or unjustifiable discrimination" between countries where the same conditions prevail, the Panel noted, first, that the health impact of remoulded tyres imported from MERCOSUR countries and their European counterparts can be expected to be comparable.<sup>407</sup> The Panel also observed that it was only after a MERCOSUR tribunal found Brazil's ban on the importation of remoulded tyres to constitute a new restriction on trade prohibited under MERCOSUR that Brazil exempted remoulded tyres originating in MERCOSUR countries from the application of the Import Ban.<sup>408</sup> For the Panel, the MERCOSUR exemption "does not seem to be motivated by capricious or unpredictable reasons [as it] was adopted further to a ruling within the framework of MERCOSUR, which has binding legal effects for Brazil, as a party to MERCOSUR."<sup>409</sup> The Panel added that the discrimination arising from the MERCOSUR exemption was not "*a priori* unreasonable", because this discrimination arose in the context of an agreement of a type expressly recognized under Article XXIV of the GATT 1994 that "inherently provides for preferential treatment in favour of its members, thus leading to discrimination between those members and other countries."<sup>410</sup>

218. The European Communities argued before the Panel that Brazil was at least partially responsible for the ruling that resulted in the MERCOSUR exemption because it did not defend itself in the MERCOSUR proceedings on grounds related to human health and safety.<sup>411</sup> The Panel was not persuaded by this submission. Indeed, the Panel considered it would not be appropriate for it "to assess in detail the choice of arguments by Brazil in the MERCOSUR proceedings or to second-guess the outcome of the case in light of Brazil's litigation strategy in those proceedings."<sup>412</sup>

219. For the Panel, the MERCOSUR ruling provided a reasonable basis to enact the MERCOSUR exemption, with the implication that the resulting discrimination is not arbitrary.<sup>413</sup> The Panel indicated, however, that it was not suggesting that "the invocation of any international agreement would be sufficient under any circumstances, in order to justify the existence of discrimination in the

<sup>407</sup>Panel Report, para. 7.270.

<sup>408</sup>*Ibid.*, para. 7.271.

<sup>409</sup>*Ibid.*, para. 7.272.

<sup>410</sup>*Ibid.*, para. 7.273.

<sup>411</sup>Article 50(d) of the Treaty of Montevideo provides for an exception similar to Article XX(b) of the GATT 1994. (See *infra*, footnote 443)

<sup>412</sup>Panel Report, para. 7.276 and footnote 1451 thereto.

<sup>413</sup>*Ibid.*, para. 7.281.

application of a measure under the chapeau of Article XX."<sup>414</sup> The Panel acknowledged that "casings from non-MERCOSUR countries, as well as casings originally used in MERCOSUR, may be retreaded in a MERCOSUR country and exported to Brazil as originating in MERCOSUR."<sup>415</sup> The Panel underscored that, "[i]f such imports were to take place in such amounts that the achievement of the objective of the measure at issue would be significantly undermined, the application of the import ban in conjunction with the MERCOSUR exemption would constitute a means of unjustifiable discrimination."<sup>416</sup> However, as of the time of the Panel's examination, "volumes of imports of retreaded tyres under the exemption appear not to have been significant."<sup>417</sup> The Panel concluded that the MERCOSUR exemption has not resulted in the Import Ban being applied in a manner that would constitute arbitrary or unjustifiable discrimination.<sup>418</sup>

220. The European Communities claims that the Panel erred in its interpretation and application of the term "arbitrary or unjustifiable discrimination" in the chapeau of Article XX of the GATT 1994, and in finding that the MERCOSUR exemption does not constitute such discrimination. According to the European Communities, whether a measure involves arbitrary or unjustifiable discrimination can only be determined by taking into account the objective of the measure at issue, in this case, the protection of life and health from risks arising from mosquito-borne diseases and tyre fires. A measure will not be arbitrary if it "appears as reasonable, predictable and foreseeable"<sup>419</sup> in the light of this objective. It follows, according to the European Communities, that the Panel erred in finding that the MERCOSUR exemption did not constitute arbitrary discrimination because it was introduced in response to a ruling of a MERCOSUR arbitral tribunal. The MERCOSUR exemption does not further but may undermine the stated objective of the measure. For this reason, it must be regarded as "unreasonable, contradictory, and thus arbitrary."<sup>420</sup> For the European Communities, allowing a Member's obligations under other international agreements to render discrimination consistent with the chapeau of Article XX would seriously undermine the effectiveness of the chapeau. The

<sup>414</sup>Panel Report, para. 7.283. The Panel also considered that it was not contrary to the terms of Article XXIV:8(a) of the GATT 1994—which specifically excludes measures taken under Article XX from the requirement to liberalize "substantially all the trade" within a customs union—to take into account, as it did, "the fact that the MERCOSUR exemption was adopted as a result of Brazil's obligations under MERCOSUR." (*Ibid.*, para. 7.284)

<sup>415</sup>*Ibid.*, para. 7.286.

<sup>416</sup>*Ibid.*, para. 7.287.

<sup>417</sup>*Ibid.*, para. 7.288. The Panel noted that imports of retreaded tyres under the MERCOSUR exemption had increased tenfold since 2002, from 200 to 2,000 tons per year by 2004. For the Panel, "[t]hat figure remains much lower than the 14,000 tons per year imported from the European Communities alone prior to the imposition of the import ban." (*Ibid.* (referring to European Communities' first written submission to the Panel, para. 80))

<sup>418</sup>*Ibid.*, para. 7.289.

<sup>419</sup>European Communities' appellant's submission, para. 321.

<sup>420</sup>*Ibid.*, para. 323.

European Communities adds that, in any event, the MERCOSUR tribunal did not oblige Brazil to discriminate between its MERCOSUR partners and other WTO Members, and that Brazil could have implemented the ruling by lifting the Import Ban for all third countries.<sup>421</sup>

221. With respect to the Panel's finding that unjustifiable discrimination could arise if imports under the MERCOSUR exemption were to take place in such amounts that the achievement of the objective of the Import Ban would be significantly undermined<sup>422</sup>, the European Communities argues that the Panel applied a test that has no basis in the text of Article XX and no support in the case law of the Appellate Body or of previous panels. The European Communities also notes that "the level of imports in a given year may be subject to strong fluctuations, and for this reason ... is entirely inadequate for the purposes of assessing the compatibility of a measure with Article XX".<sup>423</sup>

222. Brazil, for its part, supports the Panel's finding that the MERCOSUR exemption does not result in the Import Ban being applied in a manner that constitutes "arbitrary discrimination", contrary to the chapeau of Article XX. In addition, Brazil disputes the European Communities' argument that what constitutes "arbitrary discrimination" must be determined only in relation to the objective of the Import Ban. According to Brazil, the specific contents of the measure, including its policy objectives, must be examined under the exceptions listed in the paragraphs of Article XX. The chapeau of Article XX requires panels to examine whether the measure at issue is applied reasonably, in a manner that does not result in an abusive exercise of a Member's right to pursue its policy objectives. Brazil adds, for the sake of argument, that the Panel in any event considered the objective of the Import Ban when it determined that, at the time of its examination, volumes of imports of retreaded tyres under the MERCOSUR exemption did not significantly undermine the objective of the Import Ban. Furthermore, according to Brazil, the Panel was correct in finding that the ruling of the MERCOSUR tribunal provided a rational basis for the adoption of the MERCOSUR exemption.

223. For Brazil, the operation of the MERCOSUR exemption has not resulted in the Import Ban being applied in a manner that would constitute "unjustifiable discrimination". The Panel determined how Brazil's policy objective of reducing to the maximum extent possible unnecessary generation of tyre waste was being affected by imports of retreaded tyres under the MERCOSUR exemption. The level of imports and their effect on the objective of the Import Ban were relevant, in particular, because the chapeau of Article XX focuses on the application of the measure at issue.

<sup>421</sup>European Communities' appellant's submission, para. 332.

<sup>422</sup>Panel Report, para. 7.287.

<sup>423</sup>European Communities' appellant's submission, para. 340.

224. We begin our analysis by recalling that the function of the chapeau is the prevention of abuse of the exceptions specified in the paragraphs of Article XX.<sup>424</sup> In *US – Shrimp*, the Appellate Body stated that "[t]he chapeau of Article XX is, in fact, but one expression of the principle of good faith."<sup>425</sup> The Appellate Body added that "[o]ne application of this general principle, the application widely known as the doctrine of *abus de droit*, prohibits the abusive exercise of a state's rights and enjoins that whenever the assertion of a right 'impinges on the field covered by [a] treaty obligation, it must be exercised bona fide, that is to say, reasonably.'"<sup>426</sup> Accordingly, the task of interpreting and applying the chapeau is "the delicate one of locating and marking out a line of equilibrium between the right of a Member to invoke an exception under Article XX and the rights of the other Members under varying substantive provisions (e.g., Article XI) of the GATT 1994, so that neither of the competing rights will cancel out the other and thereby distort and nullify or impair the balance of rights and obligations constructed by the Members themselves in that Agreement."<sup>427</sup> The location of this line of equilibrium may move "as the kind and the shape of the measures at stake vary and as the facts making up specific cases differ."<sup>428</sup>

225. Analyzing whether discrimination is arbitrary or unjustifiable usually involves an analysis that relates primarily to the cause or the rationale of the discrimination. Thus, we observe that, in *US – Gasoline*, the Appellate Body assessed the two explanations provided by the United States for the discrimination resulting from the application of the baseline establishment rules at issue.<sup>429</sup> As it found them unsatisfactory, the Appellate Body concluded that the application of the baseline establishment rules resulted in arbitrary or unjustifiable discrimination.<sup>430</sup> In *US – Shrimp*, the Appellate Body relied on a number of factors in finding that the measure at issue resulted in arbitrary or unjustifiable discrimination. The assessment of these factors by the Appellate Body was part

<sup>424</sup>Appellate Body Report, *US – Gasoline*, p. 22, DSR 1996:1, 3, at 21.

<sup>425</sup>Appellate Body Report, *US – Shrimp*, para. 158.

<sup>426</sup>*Ibid.* (quoting B. Cheng, *General Principles of Law as applied by International Courts and Tribunals* (Stevens and Sons, Ltd., 1953), chap. 4, at 125).

<sup>427</sup>*Ibid.*, para. 159.

<sup>428</sup>*Ibid.*

<sup>429</sup>The *US – Gasoline* case involved a programme aiming to ensure that pollution from gasoline combustion did not exceed 1990 levels. Baselines for the year 1990 were set as a means for determining compliance with the programme requirements. These baselines could be either individual or statutory, depending on the nature of the entity concerned. Whereas individual baselines were available to domestic refiners, they were not to foreign refiners.

The first explanation provided by the United States for such discrimination was the impracticability of verification and enforcement of individual baselines for foreign refiners. (Appellate Body Report, *US – Gasoline*, pp. 25-26, DSR 1996:1, 3, at 23-24) Secondly, the United States explained that imposing the statutory baseline requirement on domestic refiners as well was not an option, because it was not feasible to require domestic refiners to incur the physical and financial costs and burdens entailed by immediate compliance with a statutory baseline. (*Ibid.*, p. 28, DSR 1996:1, 3, at 26-27)

<sup>430</sup>*Ibid.*, p. 29, DSR 1996:1, 3, at 27.

of an analysis that was directed at the cause, or the rationale, of the discrimination.<sup>431</sup> *US – Shrimp (Article 21.5 – Malaysia)* concerned measures taken by the United States to implement recommendations and rulings of the DSB in *US – Shrimp*. The Appellate Body's analysis of these measures under the chapeau of Article XX focused on whether discrimination that might result from the application of those measures had a legitimate cause or rationale in the light of the objectives listed in the paragraphs of Article XX.<sup>432</sup>

226. The Appellate Body Reports in *US – Gasoline*, *US – Shrimp*, and *US – Shrimp (Article 21.5 – Malaysia)* show that the analysis of whether the application of a measure results in arbitrary or unjustifiable discrimination should focus on the cause of the discrimination, or the rationale put forward to explain its existence. In this case, Brazil explained that it introduced the MERCOSUR exemption to comply with a ruling issued by a MERCOSUR arbitral tribunal. This ruling arose in the context of a challenge initiated by Uruguay against Brazil's import ban on remoulded tyres, on the grounds that it constituted a new restriction on trade prohibited under MERCOSUR. The MERCOSUR arbitral tribunal found Brazil's restrictions on the importation of remoulded tyres to be a violation of its obligations under MERCOSUR. These facts are undisputed.

227. We have to assess whether this explanation provided by Brazil is acceptable as a justification for discrimination between MERCOSUR countries and non-MERCOSUR countries in relation to retreaded tyres. In doing so, we are mindful of the function of the chapeau of Article XX, which is to prevent abuse of the exceptions specified in the paragraphs of that provision.<sup>433</sup> In our view, there is

<sup>431</sup>These factors were: (i) the discrimination that resulted from a "rigid and unbending requirement" (Appellate Body Report, *US – Shrimp*, para. 177; see also para. 163) that countries exporting shrimp into the United States adopt a regulatory programme that is essentially the same as the United States' programme; (ii) the discrimination that resulted from the failure to take into account different conditions that may occur in the territories of other WTO Members, in particular, specific policies and measures other than those applied by the United States that might have been adopted by an exporting country for the protection and conservation of sea turtles (*ibid.*, paras. 163 and 164); (iii) the discrimination that resulted from the application of the measure was "difficult to reconcile with the declared policy objective of protecting and conserving sea turtles" (*ibid.*, para. 165), because, in some circumstances, shrimp caught abroad using methods identical to those employed in the United States would be excluded from the United States market; and (iv) the discrimination that resulted from the fact that, while the United States negotiated seriously with some WTO Members exporting shrimp into the United States for the purpose of concluding international agreements for the protection and conservation of sea turtles, it did not do so with other WTO Members (*ibid.*, paras. 166 and 172).

<sup>432</sup>Thus, the Appellate Body endorsed the panel's conclusion that conditioning market access on the adoption of a regulatory programme for the protection and conservation of sea turtles comparable in effectiveness—as opposed to the adoption of "essentially the same" regulatory programme—"allows for sufficient flexibility in the application of the measure so as to avoid 'arbitrary or unjustifiable discrimination'". (Appellate Body Report, *US – Shrimp (Article 21.5 – Malaysia)*, para. 144) The Appellate Body also considered that the measures adopted by the United States permitted a degree of flexibility that would enable the United States to consider the particular conditions prevailing in Malaysia, notably because it provides that, in making certification determinations, the United States authorities "shall also take fully into account other measures the harvesting nation undertakes to protect sea turtles". (*Ibid.*, para. 147)

<sup>433</sup>Appellate Body Report, *US – Gasoline*, p. 22, DSR 1996:1, 3, at 21.

such an abuse, and, therefore, there is arbitrary or unjustifiable discrimination when a measure provisionally justified under a paragraph of Article XX is applied in a discriminatory manner "between countries where the same conditions prevail", and when the reasons given for this discrimination bear no rational connection to the objective falling within the purview of a paragraph of Article XX, or would go against that objective. The assessment of whether discrimination is arbitrary or unjustifiable should be made in the light of the objective of the measure. We note, for example, that one of the bases on which the Appellate Body relied in *US – Shrimp* for concluding that the operation of the measure at issue resulted in unjustifiable discrimination was that one particular aspect of the application of the measure (the measure implied that, in certain circumstances, shrimp caught abroad using methods identical to those employed in the United States would be excluded from the United States market<sup>434</sup>) was "difficult to reconcile with the declared objective of protecting and conserving sea turtles".<sup>435</sup> Accordingly, we have difficulty understanding how discrimination might be viewed as complying with the chapeau of Article XX when the alleged rationale for discriminating does not relate to the pursuit of or would go against the objective that was provisionally found to justify a measure under a paragraph of Article XX.

228. In this case, the discrimination between MERCOSUR countries and other WTO Members in the application of the Import Ban was introduced as a consequence of a ruling by a MERCOSUR tribunal. The tribunal found against Brazil because the restriction on imports of remoulded tyres was inconsistent with the prohibition of new trade restrictions under MERCOSUR law. In our view, the ruling issued by the MERCOSUR arbitral tribunal is not an acceptable rationale for the discrimination, because it bears no relationship to the legitimate objective pursued by the Import Ban that falls within the purview of Article XX(b), and even goes against this objective, to however small a degree. Accordingly, we are of the view that the MERCOSUR exemption has resulted in the Import Ban being applied in a manner that constitutes arbitrary or unjustifiable discrimination.

229. The Panel considered that the MERCOSUR exemption resulted in discrimination between MERCOSUR countries and other WTO Members, but that this discrimination would be "unjustifiable" only if imports of retreaded tyres entering into Brazil "were to take place in such amounts that the achievement of the objective of the measure at issue would be significantly undermined".<sup>436</sup> The Panel's interpretation implies that the determination of whether discrimination is unjustifiable depends on the quantitative impact of this discrimination on the achievement of the objective of the measure at issue. As we indicated above, analyzing whether discrimination is

<sup>434</sup>Appellate Body Report, *US – Shrimp*, para. 165.

<sup>435</sup>*Ibid.*

<sup>436</sup>Panel Report, para. 7.287.

"unjustifiable" will usually involve an analysis that relates primarily to the cause or the rationale of the discrimination. By contrast, the Panel's interpretation of the term "unjustifiable" does not depend on the cause or rationale of the discrimination but, rather, is focused exclusively on the assessment of the effects of the discrimination. The Panel's approach has no support in the text of Article XX and appears to us inconsistent with the manner the Appellate Body has interpreted and applied the concept of "arbitrary or unjustifiable discrimination" in previous cases.<sup>437</sup>

230. Having said that, we recognize that in certain cases the effects of the discrimination may be a relevant factor, among others, for determining whether the cause or rationale of the discrimination is acceptable or defensible and, ultimately, whether the discrimination is justifiable. The effects of discrimination might be relevant, depending on the circumstances of the case, because, as we indicated above<sup>438</sup>, the chapeau of Article XX deals with the manner of application of the measure at issue. Taking into account as a relevant factor, among others, the effects of the discrimination for determining whether the rationale of the discrimination is acceptable is, however, fundamentally different from the Panel's approach, which focused exclusively on the relationship between the effects of the discrimination and its justifiable or unjustifiable character.

231. We also note that the Panel found that the discrimination resulting from the MERCOSUR exemption is not arbitrary. The Panel explained that this discrimination cannot be said to be "capricious" or "random"<sup>439</sup> because it was adopted further to a ruling within the framework of MERCOSUR.<sup>440</sup>

232. Like the Panel, we believe that Brazil's decision to act in order to comply with the MERCOSUR ruling cannot be viewed as "capricious" or "random". Acts implementing a decision of a judicial or quasi-judicial body—such as the MERCOSUR arbitral tribunal—can hardly be characterized as a decision that is "capricious" or "random". However, discrimination can result from a rational decision or behaviour, and still be "arbitrary or unjustifiable", because it is explained by a

<sup>437</sup> See *supra*, paras. 225 and 226. We also observe that the Panel's approach was based on a logic that is different in nature from that followed by the Appellate Body when it addressed the national treatment principle under Article III:4 of the GATT 1994 in *Japan – Alcoholic Beverages II*. In that case, the Appellate Body stated that Article III aims to ensure "equality of competitive conditions for imported products in relation to domestic products" (Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 16, DSR 1996:1, 97, at 109). The Appellate Body added that "it is irrelevant that 'the trade effects' of the [measure at issue], as reflected in the volumes of imports, are insignificant or even non-existent". (*Ibid.*, at 110) For the Appellate Body, "Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products." (*Ibid.* (footnote omitted))

<sup>438</sup> *Supra*, para. 215.

<sup>439</sup> Panel Report, para. 7.281.

<sup>440</sup> *Ibid.*, para. 7.272.

rationale that bears no relationship to the objective of a measure provisionally justified under one of the paragraphs of Article XX, or goes against that objective.<sup>441</sup>

233. Accordingly, we find that the MERCOSUR exemption has resulted in the Import Ban being applied in a manner that constitutes arbitrary or unjustifiable discrimination. Furthermore, we reverse the Panel's finding, in paragraph 7.287 of the Panel Report, that, under the chapeau of Article XX of the GATT 1994, discrimination would be unjustifiable only if imports of retreated tyres entering into Brazil "were to take place in such amounts that the achievement of the objective of the measure at issue would be significantly undermined". We therefore reverse the Panel's findings, in paragraphs 7.288 and 7.289 of the Panel Report, that the MERCOSUR exemption has not resulted in unjustifiable discrimination. We also reverse the Panel's findings, in paragraphs 7.281 and 7.289 of the Panel Report, that, to the extent that the MERCOSUR exemption is not the result of "capricious" or "random" action, the Import Ban is not applied in a manner that would constitute arbitrary discrimination.

234. This being said, we observe, like the Panel<sup>442</sup>, that, before the arbitral tribunal established under MERCOSUR, Brazil could have sought to justify the challenged Import Ban on the grounds of human, animal, and plant health under Article 50(d) of the Treaty of Montevideo.<sup>443</sup> Brazil, however, decided not to do so. It is not appropriate for us to second-guess Brazil's decision not to invoke Article 50(d), which serves a function similar to that of Article XX(b) of the GATT 1994. However, Article 50(d) of the Treaty of Montevideo, as well as the fact that Brazil might have raised this defence in the MERCOSUR arbitral proceedings<sup>444</sup>, show, in our view, that the discrimination associated with the MERCOSUR exemption does not necessarily result from a conflict between provisions under MERCOSUR and the GATT 1994.<sup>445</sup>

<sup>441</sup> See *supra*, paras. 227 and 228.

<sup>442</sup> Panel Report, paras. 7.275 and 7.276.

<sup>443</sup> Treaty of Montevideo, Instrument Establishing the Latin American Integration Association (ALADI), done at Montevideo, August 1980 (Exhibit EC-39 submitted by the European Communities to the Panel). Article 50(d) reads as follows:

No provision under the present Treaty shall be interpreted as precluding the adoption and observance of measures regarding:

- d. Protection of human, animal and plant life and health;

<sup>444</sup> See Panel Report, para. 7.275.

<sup>445</sup> In addition, we note that Article XXIV:8(a) of the GATT 1994 exempts, where necessary, measures permitted under Article XX from the obligation to eliminate "duties and other restrictive regulations of commerce" with respect to "substantially all the trade" within a customs union. Therefore, if we assume, for the sake of argument, that MERCOSUR is consistent with Article XXIV and that the Import Ban meets the requirements of Article XX, this measure, where necessary, could be exempted by virtue of Article XXIV:8(a) from the obligation to eliminate other restrictive regulations of commerce within a customs union.

2. The MERCOSUR Exemption and Disguised Restriction on International Trade

235. The European Communities also challenges the Panel's conclusion that the MERCOSUR exemption had not been shown to date to result in the Import Ban being applied in a manner that would constitute "a disguised restriction on international trade".<sup>446</sup>

236. When examining whether the Import Ban was applied in a manner that constitutes a disguised restriction on international trade, the Panel was not persuaded by the European Communities' contention that Brazil adopted the prohibition on the importation of retreaded tyres as "a disguise to conceal the pursuit of trade-restrictive objectives".<sup>447</sup> The Panel recalled that Brazil bans both used and retreaded tyre imports; for the Panel, such an approach "is consistent with Brazil's declared objective of reducing to the greatest extent possible the unnecessary accumulation of short-lifespan tyres"<sup>448</sup>, and "in principle deprives Brazilian retreaders of the opportunity to source casings from abroad".<sup>449</sup>

237. The Panel went on to examine more specifically the European Communities' argument that "the MERCOSUR exemption results in the application of the measure in a manner that constitutes a disguised restriction on international trade, as it alters trade flows in a manner that benefits, in addition to Brazilian retreaders, retreaders from other MERCOSUR countries."<sup>450</sup> The Panel recalled that, under this exemption, "it is quite possible for retreaders from MERCOSUR countries benefiting from the exemption to source casings from abroad (for example from the European Communities), retread them locally, and then export the retreaded tyres to Brazil under the MERCOSUR exemption."<sup>451</sup> The Panel referred to the reasoning that it had developed with respect to arbitrary or unjustifiable discrimination and considered that, if imports from MERCOSUR countries were to occur in significant amounts, the Import Ban would be applied in a manner that constitutes a disguised restriction on international trade.<sup>452</sup> The Panel was however of the view that, as of the time of its examination, "the volume of imports of remoulded tyres that has actually taken place under the MERCOSUR exemption has not been significant."<sup>453</sup>

<sup>446</sup>Panel Report, para. 7.355.

<sup>447</sup>*Ibid.*, para. 7.330 (quoting Panel Report, *EC – Asbestos*, para. 8.236).

<sup>448</sup>*Ibid.*, para. 7.343.

<sup>449</sup>*Ibid.*

<sup>450</sup>*Ibid.*, para. 7.350.

<sup>451</sup>*Ibid.*, para. 7.352. (footnote omitted)

<sup>452</sup>*Ibid.*, para. 7.353.

<sup>453</sup>*Ibid.*, para. 7.354. (footnote omitted) See also *supra*, footnote 417.

238. On appeal, the European Communities does not challenge the Panel's conclusion that the Import Ban was adopted with the intention of protecting public health and the environment. Its appeal is, instead, limited to the specific findings made by the Panel in relation to the MERCOSUR exemption<sup>454</sup> and the imports of used tyres through court injunctions.<sup>455</sup> For the European Communities, the Panel addressed this question with a reasoning almost identical to that it had developed in respect of the existence of arbitrary or unjustifiable discrimination.<sup>456</sup> Therefore, the European Communities reasons, if the Panel's approach concerning arbitrary or unjustifiable discrimination is not endorsed by the Appellate Body, the Panel's finding that the MERCOSUR exemption has not been shown to date to result in a disguised restriction on international trade should also be reversed.<sup>457</sup> In response to questioning at the oral hearing, the European Communities confirmed that its claim in this regard is based on the same arguments it put forward in relation to arbitrary or unjustifiable discrimination.

239. We agree with the European Communities' observation that the reasoning developed by the Panel to reach the challenged conclusion was the same as that made in respect of arbitrary or unjustifiable discrimination. Indeed, the Panel conditioned a finding of a disguised restriction on international trade on the existence of significant imports of retreaded tyres that would undermine the achievement of the objective of the Import Ban. We explained above why we believe that the Panel erred in finding that the MERCOSUR exemption would result in arbitrary or unjustifiable discrimination only if the imports of retreaded tyres from MERCOSUR countries were to take place in such amounts that the achievement of the objective of the Import Ban would be significantly undermined.<sup>458</sup> As the Panel's conclusion that the MERCOSUR exemption has not resulted in a disguised restriction on international trade was based on an interpretation that we have reversed, this finding cannot stand. Therefore, we also *reverse* the Panel's findings, in paragraphs 7.354 and 7.355 of the Panel Report, that "the MERCOSUR exemption ... has not been shown to date to result in the [Import Ban] being applied in a manner that would constitute ... a disguised restriction on international trade."

<sup>454</sup>Panel Report, paras. 7.350-7.355.

<sup>455</sup>*Ibid.*, paras. 7.347-7.349 and 7.355. We examine this aspect of the European Communities' appeal in Section VI.B.2 of this Report.

<sup>456</sup>European Communities' appellant's submission, para. 366.

<sup>457</sup>*Ibid.*, paras. 367 and 368.

<sup>458</sup>*Supra*, Section VI.A.1.

B. *Imports of Used Tyres through Court Injunctions and the Chapeau of Article XX of the GATT 1994*

1. Imports of Used Tyres through Court Injunctions and Arbitrary or Unjustifiable Discrimination

240. The European Communities submits that the Panel erred in its analysis of the imports of used tyres through court injunctions under the chapeau of Article XX of the GATT 1994. We begin our analysis with the requirement in the chapeau of Article XX that the measure at issue not be applied in a manner that would result in "arbitrary or unjustifiable discrimination".

241. The Panel determined that the imports of used tyres through court injunctions resulted in discrimination in favour of domestic retreaders. This is because these imports enabled retreaded tyres to be produced in Brazil from imported casings, while retreaded tyres produced abroad using the same casings could not be imported.<sup>459</sup> Having done so, the Panel went on to examine whether this discrimination is arbitrary or unjustifiable.

242. The Panel noted that the importation of used tyres into Brazil is prohibited, and that "used tyres have been imported into Brazil in recent years only as a result of injunctions granted by Brazilian courts in specific cases."<sup>460</sup> The Panel found that the discrimination resulting from the imports of used tyres through court injunctions was not the consequence of a "capricious" or "random" action, and that, to this extent, the Import Ban was not applied in a manner that would constitute arbitrary discrimination.<sup>461</sup>

243. The Panel recalled, however, that the contribution of the Import Ban to the achievement of its objective "is premised on imports of used tyres being prohibited".<sup>462</sup> For the Panel, the granting of injunctions allowing used tyres to be imported "runs directly counter to this premise, as it effectively allows the very used tyres that are prevented from entering into Brazil *after* retreading to be imported *before* retreading."<sup>463</sup> The Panel examined the volumes of imports of used tyres that have taken place under the court injunctions. For the Panel, the amounts of imports of used tyres that have

<sup>459</sup>Panel Report, para. 7.243.

<sup>460</sup>*Ibid.*, para. 7.292. (footnote omitted) The Panel also observed that Brazil has challenged these injunctions "with a certain degree of success". (*Ibid.*) For the Panel, the imports of used tyres were "the result of successful court challenges", and found their basis "in the customs authorities' need to give effect to judicial orders". (*Ibid.*) The Panel added that nothing in the evidence suggested that the decisions of the Brazilian courts granting those injunctions were capricious or unpredictable, nor does "the decision of the Brazilian administrative authorities to comply with the preliminary injunctions ... seem irrational or unpredictable". (*Ibid.*, para. 7.293)

<sup>461</sup>*Ibid.*, para. 7.294.

<sup>462</sup>*Ibid.*, para. 7.295.

<sup>463</sup>*Ibid.* (original emphasis)

actually taken place under the court injunctions were significant.<sup>464</sup> Accordingly, the Panel found that, "since used tyre imports have been taking place under the court injunctions in such amounts that the achievement of Brazil's declared objective is being significantly undermined, the measure at issue is being applied in a manner that constitutes a means of unjustifiable discrimination."<sup>465</sup>

244. For the European Communities, the Panel erred in finding that the imports of used tyres through court injunctions do not result in arbitrary discrimination, given that "[w]hat is arbitrary must be decided in the light of the stated objectives of the measure".<sup>466</sup> Because, from the point of view of the protection of human life or health, there is no difference between, on the one hand, a retreaded tyre produced in the European Communities and, on the other hand, a retreaded tyre produced in Brazil from a casing imported from the European Communities, prohibiting imported retreaded tyres while allowing the importation of used tyres through court injunctions must be regarded as constituting arbitrary discrimination.<sup>467</sup> Furthermore, the European Communities maintains that, as regards the issue of whether court injunctions constitute unjustifiable discrimination, the Panel adopted the same erroneous quantitative approach as it did when discussing the MERCOSUR exemption.<sup>468</sup> The European Communities adds that the Panel's approach engenders uncertainty for the implementation of the Panel Report, because the Panel did not identify "the threshold below which the imports of used tyres would no longer be significant".<sup>469</sup>

245. Brazil submits that the Panel did not err in the analytical approach it adopted to determine whether imports of used tyres under court injunctions resulted in the Import Ban being applied in a manner that constituted "arbitrary or unjustifiable discrimination" under the chapeau of Article XX. For Brazil, it was appropriate for the Panel to consider the level of imports of used tyres in its determination. Brazil thus dismisses the European Communities' argument that the Panel's approach engenders uncertainty for the implementation of the Panel Report, and stresses that the monitoring of a WTO Member's compliance is an integral part of the dispute settlement system.

<sup>464</sup>Panel Report, paras. 7.297 and 7.303. In particular, the Panel noted that, in 2005, Brazil imported approximately 10.5 million used tyres, compared to 1.4 million in 2000, the year in which the ban on imports of used and retreaded tyres was first enacted (Portaria SECEX 8/2000). The Panel also observed that the total number of retreaded tyres imported annually to Brazil, from all sources, was 2.3 million prior to the Import Ban. Thus, according to the Panel, in 2005, the imports of used tyres were approximately three times the amount of retreaded and used tyres combined that were imported annually prior to the Import Ban. (*Ibid.*, paras. 7.301 and 7.302)

<sup>465</sup>*Ibid.*, para. 7.306.

<sup>466</sup>European Communities' appellant's submission, para. 357.

<sup>467</sup>*Ibid.*

<sup>468</sup>*Ibid.*, para. 360.

<sup>469</sup>*Ibid.*, para. 363.

246. As we explained above, the analysis of whether the application of a measure results in arbitrary or unjustifiable discrimination should focus on the cause or rationale given for the discrimination.<sup>470</sup> For Brazil, the fact that Brazilian rereaders are able to use imported casings is the result of the decisions of the Brazilian administrative authorities to comply with court injunctions.<sup>471</sup> We observe that this explanation bears no relationship to the objective of the Import Ban—reducing exposure to the risks arising from the accumulation of waste tyres to the maximum extent possible. The imports of used tyres through court injunctions even go against the objective pursued by the Import Ban. As we indicated above, there is arbitrary or unjustifiable discrimination, within the meaning of the chapeau of Article XX, when a Member seeks to justify the discrimination resulting from the application of its measure by a rationale that bears no relationship to the accomplishment of the objective that falls within the purview of one of the paragraphs of Article XX, or goes against this objective. Accordingly, we *find* that the imports of used tyres through court injunctions have resulted in the Import Ban being applied in a manner that constitutes arbitrary or unjustifiable discrimination.

247. The Panel approached the question of whether the imports of used tyres through court injunctions result in unjustifiable discrimination in the same manner as it did with the MERCOSUR exemption. We explained above why we are of the view that this quantitative approach—according to which discrimination would be characterized as unjustifiable only if imports under the MERCOSUR exemption take place in such amounts that the achievement of the objective of the measure at issue would be "significantly undermined"<sup>472</sup>—is flawed.<sup>473</sup> Accordingly, we *reverse* the Panel's findings, in paragraphs 7.296 and 7.306 of the Panel Report, that the imports of used tyres through court injunctions have resulted in the Import Ban being applied in a manner that constitutes unjustifiable discrimination only to the extent that such imports have taken place in volumes that significantly undermine the achievement of the objective of the Import Ban. Furthermore, for the same reasons as those explained in paragraph 232, we *reverse* the Panel's finding, in paragraph 7.294 of the Panel Report, that the imports of used tyres under court injunctions have not resulted in arbitrary discrimination to the extent that such imports are not the result of "capricious" or "random" action.

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<sup>470</sup>*Supra*, Section VI.A.1.

<sup>471</sup>See Panel Report, paras. 7.292 and 7.293; see also Brazil's appellee's submission, para. 245.

<sup>472</sup>Panel Report, para. 7.287 (as regards the MERCOSUR exemption); see also para. 7.296 (with respect to the imports of used tyres through court injunctions).

<sup>473</sup>*Supra*, Section VI.A.1.

2. Imports of Used Tyres and Disguised Restriction on International Trade

248. The Panel found that, "since imports of used tyres take place in significant amounts under court injunctions to the benefit of the domestic rereading industry, the [Import Ban] is being applied in a manner that constitutes a disguised restriction on international trade."<sup>474</sup> The Panel reasoned that the restriction on international trade inherent in the Import Ban has operated to the benefit of domestic rereaders, because "[t]he granting of court injunctions for the importation of used tyres has ... in effect meant that ... domestic rereaders have been able to continue to benefit from the importation of used tyres as material for their own activity in significant amounts, while their competitors from non-MERCOSUR countries have been kept out of the Brazilian market."<sup>475</sup>

249. The European Communities submits that the Panel erred in finding that the imports of used tyres through court injunctions would have resulted in the Import Ban being applied in a manner that constitutes a disguised restriction on international trade only to the extent that these imports are taking place in such quantities that they significantly undermine the objective of the Import Ban.<sup>476</sup> The European Communities refers to the arguments it made regarding the existence of arbitrary or unjustifiable discrimination, and reiterates its view that the Panel's reliance on import volumes for the purpose of determining compatibility with the chapeau of Article XX of the GATT 1994 is erroneous.<sup>477</sup>

250. Brazil argues that the Panel correctly considered the volume of imports of used tyres as part of its determination that the Import Ban was being applied in a manner that constituted a disguised restriction on international trade, and refers to the arguments that it made before the Panel in support of this position.

251. The reasoning elaborated by the Panel to reach the challenged finding was the same as that it developed in respect of "arbitrary or unjustifiable discrimination". Indeed, the Panel conditioned a finding of a disguised restriction on international trade on the existence of imports of used tyres in amounts that would significantly undermine the achievement of the objective of the Import Ban. We explained above why we consider this reasoning of the Panel erroneous. As the challenged finding results from the same reasoning that we have found to be erroneous and have rejected, this finding of the Panel cannot stand. Accordingly, we *reverse* the Panel's finding, in paragraph 7.349 of the Panel Report, that the imports of used tyres through court injunctions have resulted in the Import Ban being

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<sup>474</sup>Panel Report, para. 7.349.

<sup>475</sup>*Ibid.*, para. 7.348. (footnote omitted)

<sup>476</sup>*Ibid.*, para. 7.349.

<sup>477</sup>European Communities' appellant's submission, para. 367.

applied in a manner that constitutes a disguised restriction on international trade only to the extent that these imports are taking place in such quantities that they significantly undermine the objective of the Import Ban.

252. We found that the MERCOSUR exemption and the imports of used tyres under court injunctions have resulted in the Import Ban being applied in a manner that is inconsistent with the chapeau of Article XX of the GATT 1994. In the light of these findings, we *uphold*, albeit for different reasons, the Panel's findings, in paragraphs 7.357 and 8.1(a)(i) and (ii) of the Panel Report, that the Import Ban, found by the Panel to be inconsistent with Article XI:1 of the GATT 1994, is not justified under Article XX of the GATT 1994.

**VII. The European Communities' Claims that the MERCOSUR Exemption Is Inconsistent with Article I:1 and Article XIII:1 of the GATT 1994**

253. Before the Panel, the European Communities made separate claims regarding the MERCOSUR exemption, namely, that the MERCOSUR exemption was inconsistent with Article I:1 and Article XIII:1 of the GATT 1994. Brazil did not contest that the MERCOSUR exemption was *prima facie* inconsistent with Articles I:1 and XIII:1, but claimed that it was justified under Articles XX(d) and XXIV of the GATT 1994.

254. After noting that the MERCOSUR exemption and the Import Ban have the same legal basis, namely, Article 40 of Portaria SECEX 14/2004<sup>478</sup>, the Panel emphasized that, under Article 11 of the DSU, "it was required to address only those issues that are necessary for the resolution of the matter between the parties."<sup>479</sup> The Panel recalled its earlier findings that the Import Ban was inconsistent with Article XI:1 and not justified under Article XX(b). It then decided to exercise judicial economy in respect of the European Communities' separate claims that the MERCOSUR exemption was inconsistent with Article I:1 and Article XIII:1, and not justified under Articles XX(d) or Article XXIV of the GATT 1994. According to the Panel, the MERCOSUR exemption derives from Article XXIV of the GATT 1994. The Panel reasoned that, as it had already found that the Import Ban was inconsistent with the requirements of the GATT 1994, it was unnecessary to examine the European Communities' separate claims regarding the MERCOSUR exemption.<sup>480</sup>

<sup>478</sup>See Panel Report, para. 7.453.

<sup>479</sup>*Ibid.*, para. 7.454 (referring to Appellate Body Report, *US – Wool Shirts and Blouses*, p. 18, DSR 1996:1, 323, at 339).

<sup>480</sup>*Ibid.*, para. 7.455.

255. On appeal, the European Communities requests that we reverse the Panel's decision to exercise judicial economy in relation to its separate claims regarding the MERCOSUR exemption. The European Communities also requests us to complete the legal analysis and find that the MERCOSUR exemption is inconsistent with Articles I:1 and XIII:1, and not justified under Article XX(d) or Article XXIV of the GATT 1994. This request, however, is conditioned upon our upholding the Panel's finding that the MERCOSUR exemption does not result in the Import Ban being applied inconsistently with the requirements of the chapeau of Article XX.

256. As we have found that the MERCOSUR exemption results in the Import Ban being applied inconsistently with the chapeau of Article XX, the condition on which the European Communities' request is predicated has not been fulfilled. It is therefore not necessary for us to rule on the European Communities' conditional appeal. Accordingly, we do not examine the European Communities' conditional appeal and make no finding in relation to its separate claims that the MERCOSUR exemption is inconsistent with Article I:1 and Article XIII:1 of the GATT 1994, and not justified under Article XX(d) or Article XXIV of the GATT 1994.

257. Having said that, we observe that it might have been appropriate for the Panel to address the European Communities' separate claims that the MERCOSUR exemption was inconsistent with Article I:1 and Article XIII:1. We have previously indicated that the principle of judicial economy "allows a panel to refrain from making multiple findings that the same measure is inconsistent with various provisions when a single, or a certain number of findings of inconsistency, would suffice to resolve the dispute"<sup>481</sup>, and it seems that the Panel assumed this to be the case in the present dispute. However, the Panel found that the MERCOSUR exemption resulted in the Import Ban being applied *consistently* with the requirements of the chapeau of Article XX. In view of this finding, we must acknowledge that we have difficulty seeing how the Panel could have been justified in not addressing the separate claims of inconsistency under Article I:1 and Article XIII:1 directed at the MERCOSUR exemption. We emphasize that panels must be mindful, when applying the principle of judicial economy, that the aim of the dispute settlement mechanism under Article 3.7 of the DSU is to secure a positive solution to the dispute. Therefore, a panel's discretion to decline to rule on different claims of inconsistency adduced in relation to the same measure is limited by its duty to make findings that will allow the DSB to make sufficiently precise recommendations and rulings 'in order to ensure effective resolution of disputes to the benefit of all Members.'<sup>482</sup>

<sup>481</sup>Appellate Body Report, *Canada – Wheat Exports and Grain Imports*, para. 133.

<sup>482</sup>Appellate Body Report, *Australia – Salmon*, para. 223.

**VIII. Findings and Conclusions**

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

- (a) with respect to the analysis of the necessity of the Import Ban under Article XX(b) of the GATT 1994:
  - (i) upholds the Panel's findings, in paragraph 7.215 of the Panel Report, that the Import Ban can be considered "necessary" within the meaning of Article XX(b) and is thus provisionally justified under that provision; and
  - (ii) finds that the Panel did not breach its duty under Article 11 of the DSU to make an objective assessment of the facts;
- (b) with respect to the analysis under the chapeau of Article XX of the GATT 1994:
  - (i) reverses the Panel's findings, in paragraphs 7.287, 7.354, and 7.355 of the Panel Report, that the MERCOSUR exemption would result in the Import Ban being applied in a manner that constitutes unjustifiable discrimination and a disguised restriction on international trade only to the extent that it results in volumes of imports of retreaded tyres that would significantly undermine the achievement of the objective of the Import Ban;
  - (ii) reverses the Panel's findings, in paragraphs 7.281 and 7.289 of the Panel Report, that the MERCOSUR exemption has not resulted in arbitrary discrimination; also reverses the Panel's findings, in paragraphs 7.288 and 7.289 of the Panel Report, that the MERCOSUR exemption has not resulted in unjustifiable discrimination; and finds, instead, that the MERCOSUR exemption has resulted in the Import Ban being applied in a manner that constitutes arbitrary or unjustifiable discrimination within the meaning of the chapeau of Article XX;
  - (iii) reverses the Panel's findings, in paragraphs 7.296, 7.306, 7.349, and 7.355 of the Panel Report, that the imports of used tyres under court injunctions have resulted in the Import Ban being applied in a manner that constitutes unjustifiable discrimination and a disguised restriction on international trade only to the extent that such imports have taken place in volumes that significantly undermine the achievement of the objective of the Import Ban;

- (iv) reverses the Panel's finding, in paragraph 7.294 of the Panel Report, that the imports of used tyres under court injunctions have not resulted in arbitrary discrimination; and finds, instead, that the imports of used tyres under court injunctions have resulted in the Import Ban being applied in a manner that constitutes arbitrary or unjustifiable discrimination within the meaning of the chapeau of Article XX; and
  - (c) with respect to Article XX of the GATT 1994, upholds, albeit for different reasons, the Panel's findings, in paragraphs 7.357 and 8.1(a)(i) and (ii) of the Panel Report, that the Import Ban is not justified under Article XX of the GATT 1994; and
  - (d) with respect to the European Communities' claims that the MERCOSUR exemption is inconsistent with Article I:1 and Article XIII:1 of the GATT 1994, finds that the condition on which the European Communities' appeal is predicated is not satisfied, and therefore does not consider it.
259. The Appellate Body recommends that the DSB request Brazil to bring its measure, found in this Report, and in the Panel Report as modified by this Report, to be inconsistent with the GATT 1994, into conformity with its obligations under that Agreement.

Signed in the original in Geneva this 16th day of November 2007 by:

ANNEX I

# WORLD TRADE ORGANIZATION

WT/DS332/9  
3 September 2007  
(07-3724)

Original: English

## BRAZIL – MEASURES AFFECTING IMPORTS OF RETREADED TYRES

Notification of an Appeal by the European Communities under Article 16.4 and Article 17 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), and under Rule 20(1) of the Working Procedures for Appellate Review

Georges Abi-Saab  
Presiding Member

Luiz Olavo Baptista  
Member

Yasuhei Taniguchi  
Member

The following notification, dated 3 September 2007, from the Delegation of the European Commission, is being circulated to Members.

1. Pursuant to Article 16.4 and Article 17 of the DSU and to Rule 20.1 of the Working Procedures for Appellate Review, the European Communities submits its Notice of Appeal on certain issues of law covered in the Report of the Panel on *Brazil – Measures Affecting Imports of Retreaded Tyres*<sup>1</sup> and certain legal interpretations developed by the Panel.

2. The European Communities seeks review by the Appellate Body of the following aspects of the Report of the Panel:

(a) The Panel's finding that the import ban on retreaded tyres was necessary within the meaning of Article XX(b) of the GATT. The Panel's finding and corresponding reasoning are contained in paragraphs 7.103 to 7.216 of the Panel Report. The EC appeals this finding notably because:

- in assessing the contribution of the measure to the protection of human, animal and plant life and health, the Panel merely assesses whether the ban is capable of making a potential contribution to its stated objectives. This reasoning is inconsistent with Article XX(b) of the GATT. Moreover, in reaching its conclusion regarding the potential contribution of the ban, the Panel also fails to make an objective assessment of the matter before it, including of the facts of the case, as required by Article 11 of the DSU, and effectively shifts the burden of proof to the EC;

<sup>1</sup> WT/DS332/R, circulated on 12 June 2007.

- in assessing the reasonably available alternative measures, the Panel wrongly excludes some of the alternatives proposed by the European Communities, on the basis that those alternatives are related to the manner in which the import ban is implemented *in practice*, that they are not necessarily readily available, that they do not avoid the waste tyres arising specifically from imported retreaded tyres, that they already exist in Brazil, or that they are individually capable of disposing only of a small number of waste tyres. Moreover, the Panel has ignored important facts and arguments presented by the European Communities, has referred to the evidence submitted by the parties in a selective and distorted manner, and has effectively shifted the burden of proof to the EC. These findings are inconsistent with Article XX(b) of the GATT and with the Panel's duty to make an objective assessment of the matter before it, including of the facts of the case, as required by Article 11 of the DSU;
- contrary to Article XX (b) of the GATT, the Panel has erred by not carrying out a process of weighing and balancing the relevant factors and elements (objective pursued, trade-restrictiveness of the measure, contribution and alternatives);
- (b) the Panel's finding that the exemption, from the import ban and other challenged measures, of imports of retreaded tyres from other Mercosur countries does not constitute arbitrary or unjustifiable discrimination (paragraphs 7.270 to 7.289 of the Panel Report). This finding is inconsistent with the chapeau of Article XX of the GATT;
- (c) the Panel's finding that the imports of used tyres do not constitute arbitrary discrimination and that they constitute unjustified discrimination only to the extent that they significantly undermine the objectives of the ban (paragraphs 7.292 to 7.294, 7.296 and 7.306 of the Panel Report). This finding is inconsistent with the chapeau of Article XX of the GATT;
- (d) the Panel's finding that the Mercosur exemption does not constitute a disguised restriction on international trade, and that imports of used tyres would constitute a disguised restriction only to the extent that they significantly undermine the objectives of the ban (paragraphs 7.347 to 7.355 of the Panel Report). This finding is inconsistent with the chapeau of Article XX of the GATT;
- (e) the Panel's decision to exercise judicial economy with respect to the European Communities' claims under Articles XIII:1 and I:1 of the GATT (paragraphs 7.453 to 7.456 and 8.2 of the Panel Report). Since the Panel found that the Mercosur exemption is not incompatible with the chapeau of Article XX GATT, a separate finding on the compatibility of this exemption with Articles XIII:1 and I:1 GATT would have been necessary to secure a positive resolution of the dispute, as required by Articles 3.3, 3.4, 3.7 and 11 of the DSU. The European Communities therefore asks the Appellate Body to find that the Mercosur exemption is incompatible with Articles XIII:1 and I:1 of the GATT, and is not justified either by Article XXIV or by Article XX(d) of the GATT.

**World Trade Organization**

**United States – Measures Affecting the Production and Sale of  
Clove Cigarettes**

**Report of the Appellate Body, 4 April 2012**

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<i>Australia – Salmon</i>	Appellate Body Report, <i>Australia – Measures Affecting Importation of Salmon</i> , WT/DS18/AB/R, adopted 6 November 1998, DSR 1998:VIII, 3327
<i>Border Tax Adjustments</i>	Working Party Report, <i>Border Tax Adjustments</i> , L/3464, adopted 2 December 1970, BISD 18S/97
<i>Brazil – Retreaded Tyres</i>	Appellate Body Report, <i>Brazil – Measures Affecting Imports of Retreaded Tyres</i> , WT/DS332/AB/R, adopted 17 December 2007, DSR 2007:IV, 1527
<i>Canada – Provincial Liquor Boards (US)</i>	GATT Panel Report, <i>Canada – Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies</i> , DS17/R, adopted 18 February 1992, BISD 39S/27
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<i>Chile – Price Band System</i>	Appellate Body Report, <i>Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products</i> , WT/DS207/AB/R, adopted 23 October 2002, DSR 2002:VIII, 3045 (Corr.1, DSR 2006:XII, 5473)
<i>Chile – Price Band System (Article 21.5 – Argentina)</i>	Appellate Body Report, <i>Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products – Recourse to Article 21.5 of the DSU by Argentina</i> , WT/DS207/AB/RW, adopted 22 May 2007, DSR 2007:II, 513
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<i>EC – Asbestos</i>	Appellate Body Report, <i>European Communities – Measures Affecting Asbestos and Asbestos-Containing Products</i> , WT/DS135/AB/R, adopted 5 April 2001, DSR 2001:VII, 3243
<i>EC – Bananas III</i>	Panel Reports, <i>European Communities – Regime for the Importation, Sale and Distribution of Bananas ("EC – Bananas III")</i> , WT/DS27/R/ECU (Ecuador) / WT/DS27/R/GTM, WT/DS27/R/HND (Guatemala and Honduras) / WT/DS27/R/MEX (Mexico) / WT/DS27/R/USA (US), adopted 25 September 1997, as modified by Appellate Body Report WT/DS27/AB/R, DSR 1997:II, 695 to DSR 1997:III, 1085

Short Title	Full case title and citation
EC – Bananas III (Article 21.5 – Ecuador II) / EC – Bananas III (Article 21.5 – US)	Appellate Body Reports, <i>European Communities – Regime for the Importation, Sale and Distribution of Bananas – Second Recourse to Article 21.5 of the DSU by Ecuador</i> , WT/DS27/AB/RW2/ECU, adopted 11 December 2008, and Corr.1 / <i>European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Article 21.5 of the DSU by the United States</i> , WT/DS27/AB/RW/USA and Corr.1, adopted 22 December 2008
EC – Bed Linen (Article 21.5 – India)	Appellate Body Report, <i>European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by India</i> , WT/DS141/AB/RW, adopted 24 April 2003, DSR 2003:III, 965
EC – Fasteners (China)	Appellate Body Report, <i>European Communities – Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China</i> , WT/DS397/AB/R, adopted 28 July 2011
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Japan – Apples	Appellate Body Report, <i>Japan – Measures Affecting the Importation of Apples</i> , WT/DS245/AB/R, adopted 10 December 2003, DSR 2003:IX, 4391
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Mexico – Taxes on Soft Drinks	Appellate Body Report, <i>Mexico – Tax Measures on Soft Drinks and Other Beverages</i> , WT/DS308/AB/R, adopted 24 March 2006, DSR 2006:1, 3
Philippines – Distilled Spirits	Appellate Body Reports, <i>Philippines – Taxes on Distilled Spirits</i> , WT/DS396/AB/R / WT/DS403/AB/R, adopted 20 January 2012
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Thailand – Cigarettes (Philippines)	Appellate Body Report, <i>Thailand – Customs and Fiscal Measures on Cigarettes from the Philippines</i> , WT/DS371/AB/R, adopted 15 July 2011

Short Title	Full case title and citation
US – Carbon Steel	Appellate Body Report, <i>United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany</i> , WT/DS213/AB/R and Corr.1, adopted 19 December 2002, DSR 2002:IX, 3779
US – Clove Cigarettes	Panel Report, <i>United States – Measures Affecting the Production and Sale of Clove Cigarettes</i> , WT/DS406/R, circulated to WTO Members 2 September 2011
US – Gasoline	Panel Report, <i>United States – Standards for Reformulated and Conventional Gasoline</i> , WT/DS2/R, adopted 20 May 1996, as modified by Appellate Body Report WT/DS2/AB/R, DSR 1996:1, 29
US – Section 337 Tariff Act	GATT Panel Report, <i>United States Section 337 of the Tariff Act of 1930</i> , L/6439, adopted 7 November 1989, BISD 36S/345
US – Stainless Steel (Mexico)	Appellate Body Report, <i>United States – Final Anti-Dumping Measures on Stainless Steel from Mexico</i> , WT/DS344/AB/R, adopted 20 May 2008, DSR 2008:II, 513
US – Steel Safeguards	Appellate Body Report, <i>United States – Definitive Safeguard Measures on Imports of Certain Steel Products</i> , WT/DS248/AB/R, WT/DS249/AB/R, WT/DS251/AB/R, WT/DS252/AB/R, WT/DS253/AB/R, WT/DS254/AB/R, WT/DS258/AB/R, WT/DS259/AB/R, adopted 10 December 2003, DSR 2003:VII, 3117
US – Tuna (II) (Mexico)	Panel Report, <i>United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products</i> , WT/DS381/R, circulated to WTO Members 15 September 2011
US – Tuna II (Mexico)	Panel Report, <i>United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products</i> , WT/DS381/R, circulated to WTO Members 15 September 2011 [appeal in progress]
US – Upland Cotton (Article 21.5 – Brazil)	Appellate Body Report, <i>United States – Subsidies on Upland Cotton – Recourse to Article 21.5 of the DSU by Brazil</i> , WT/DS267/AB/RW, adopted 20 June 2008, DSR 2008:III, 809
US – Wheat Gluten	Appellate Body Report, <i>United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities</i> , WT/DS166/AB/R, adopted 19 January 2001, DSR 2001:II, 717
US – Wool Shirts and Blouses	Appellate Body Report, <i>United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India</i> , WT/DS33/AB/R, adopted 23 May 1997, and Corr.1, DSR 1997:I, 323

ABBREVIATIONS USED IN THIS REPORT

Abbreviation	Description
Doha Ministerial Decision	Doha Ministerial Decision on Implementation-Related Issues and Concerns, Decision of 14 November 2011, WT/MIN(01)/17
DSB	Dispute Settlement Body
DSU	<i>Understanding on Rules and Procedures Governing the Settlement of Disputes</i>
FDA	United States Food and Drug Administration
FDA Guidance	Guidance for Industry and FDA Staff, "General Questions and Answers on the Ban of Cigarettes that Contain Characterizing Flavors (Edition 2)", 23 December 2009 (Panel Exhibit IND-41)
FFDCA	United States Federal Food, Drug and Cosmetic Act, <i>United States Code</i> , Title 21, Chapter 9
FSPTCA	United States Family Smoking Prevention and Tobacco Control Act, Public Law No. 111-31, 123 Stat. 1776 (22 June 2009) (Panel Exhibit US-7)
GATT 1994	<i>General Agreement on Tariffs and Trade 1994</i>
House Report	House Energy and Commerce Committee Report, H.R. No. 111-58, Pt. 1 (2009) (Panel Exhibits IND-2 and US-67)
ILC	International Law Commission
March 2011 TPSAC Report	Report by the Tobacco Products Scientific Advisory Committee to the FDA, March 2011 available at <http://www.fda.gov/downloads/AdvisoryCommittees/CommitteesMeetingMaterials/TobaccoProducts/ScientificAdvisoryCommittee/UCM247689.pdf>
Panel Report	Panel Report, <i>United States – Measures Affecting the Production and Sale of Clove Cigarettes</i> , WT/DS406/R
Section 907(a)(1)(A)	Section 907(a)(1)(A) of the FFDCA (as amended by the FSPTCA), codified at <i>United States Code</i> , Title 21, Chapter 9, section 387g(a)(1)(A)
TBT Agreement	<i>Agreement on Technical Barriers to Trade</i>
Vienna Convention	<i>Vienna Convention on the Law of Treaties</i> , done at Vienna, 23 May 1969, 1155 UNITS, 8 International Legal Materials 679
WHO	World Health Organization
Working Procedures	<i>Working Procedures for Appellate Review</i> , WT/AB/WP/6, 16 August 2010
WTO	World Trade Organization
WTO Agreement	<i>Marrakesh Agreement Establishing the World Trade Organization</i>

WORLD TRADE ORGANIZATION  
APPELLATE BODY

United States – Measures Affecting the Production and Sale of Clove Cigarettes	AB-2012-1
United States, <i>Appellant</i> Indonesia, <i>Appellee</i>	Present:
Brazil, <i>Third Participant</i> Colombia, <i>Third Participant</i> Dominican Republic, <i>Third Participant</i> European Union, <i>Third Participant</i> Guatemala, <i>Third Participant</i> Mexico, <i>Third Participant</i> Norway, <i>Third Participant</i> Turkey, <i>Third Participant</i>	Oshima, Presiding Member Ramirez-Hernández, Member Van den Bossche, Member

**I. Introduction**

1. The United States appeals certain issues of law and legal interpretations developed in the Panel Report, *United States – Measures Affecting the Production and Sale of Clove Cigarettes*<sup>1</sup> (the "Panel Report"). The Panel was established on 20 July 2010 to consider a complaint by Indonesia with respect to a measure adopted by the United States that prohibits cigarettes with characterizing flavours, other than tobacco or menthol.

2. Before the Panel, Indonesia claimed that the United States acted inconsistently with its substantive and procedural obligations under the *Agreement on Technical Barriers to Trade* (the "TBT Agreement") and the *General Agreement on Tariffs and Trade 1994* (the "GATT 1994"). In particular, Indonesia claimed that Section 907(a)(1)(A) of the United States Federal Food, Drug and Cosmetic Act<sup>2</sup> (the "FFDCA")—as amended by the Family Smoking Prevention and Tobacco Control Act<sup>3</sup> (the "FSPTCA")—was inconsistent with Articles 2.1, 2.2, 2.5, 2.8, 2.9, 2.10, 2.12, and 12.3 of the *TBT Agreement*. Alternatively, Indonesia claimed that Section 907(a)(1)(A) was inconsistent with Article III:4 of the GATT 1994<sup>4</sup>, and could not be justified under Article XX(b) thereof.<sup>5</sup>

<sup>1</sup>WT/DS406/R, 2 September 2011.

<sup>2</sup>Codified at *United States Code*, Title 21, Chapter 9, section 387g(a)(1)(A).

<sup>3</sup>United States Family Smoking Prevention and Tobacco Control Act, Public Law No. 111-31, 123 Stat. 1776 (22 June 2009) (Panel Exhibit US-7).

<sup>4</sup>Panel Report, para. 3.1.

<sup>5</sup>Panel Report, para. 7.299 (referring to Indonesia's first written submission to the Panel, paras. 114-127).

3. The Panel Report was circulated to Members of the World Trade Organization (the "WTO") on 2 September 2011. The Panel found that Section 907(a)(1)(A) was inconsistent with Article 2.1 of the *TBT Agreement* because it accorded to imported clove cigarettes less favourable treatment than that accorded to like menthol cigarettes of national origin.<sup>6</sup> Having found that Section 907(a)(1)(A) was inconsistent with Article 2.1 of the *TBT Agreement*, the Panel declined to rule on Indonesia's alternative claim under Article III:4 of the GATT 1994 and on the United States' related defence under Article XX(b) of the GATT 1994.<sup>7</sup>

4. The Panel further found that the United States acted inconsistently with Article 2.9.2 of the *TBT Agreement* by failing to notify to WTO Members, through the Secretariat, the products to be covered by the proposed Section 907(a)(1)(A), together with a brief indication of its objective and rationale, at an appropriate early stage when amendments and comments were still possible.<sup>8</sup> The Panel also found that the United States acted inconsistently with Article 2.12 of the *TBT Agreement* by not allowing an interval of no less than six months between the publication and the entry into force of Section 907(a)(1)(A).<sup>9</sup>

5. Conversely, the Panel rejected Indonesia's claims under Articles 2.2, 2.5, 2.8, 2.9.3, 2.10, and 12.3 of the *TBT Agreement*. More specifically, the Panel found that Indonesia failed to demonstrate that Section 907(a)(1)(A) was inconsistent with Article 2.2 of the *TBT Agreement* to the extent that its ban on clove cigarettes was more trade restrictive than necessary to fulfil the legitimate objective of reducing youth smoking, taking account of the risks non-fulfilment would create.<sup>10</sup> The Panel also concluded that Indonesia failed to demonstrate that the United States had acted inconsistently with Article 2.5 of the *TBT Agreement*, because Indonesia did not request the United States to explain the justification for Section 907(a)(1)(A) "in terms of Articles 2.2 and 2.4 of the *TBT Agreement*".<sup>11</sup> Similarly, the Panel found that Indonesia failed to demonstrate that it would be "appropriate" to formulate the technical regulation in Section 907(a)(1)(A) in terms of "performance" rather than design or descriptive characteristics, within the meaning of Article 2.8 of the *TBT Agreement*.<sup>12</sup>

6. The Panel further found that Indonesia failed to demonstrate that the United States had acted inconsistently with Article 2.9.3 of the *TBT Agreement*, because Indonesia did not request the

<sup>6</sup>Panel Report, paras. 7.293 and 8.1(b).

<sup>7</sup>Panel Report, paras. 7.294, 7.310, 8.3, and 8.4.

<sup>8</sup>Panel Report, paras. 7.550 and 8.1(f).

<sup>9</sup>Panel Report, paras. 7.595 and 8.1(h).

<sup>10</sup>Panel Report, paras. 7.432 and 8.1(e).

<sup>11</sup>Panel Report, paras. 7.461, 7.463, and 8.1(d).

<sup>12</sup>Panel Report, paras. 7.497, 7.498, and 8.1(e).

United States to provide particulars or copies of Section 907(a)(1)(A) while it was still in draft form.<sup>13</sup> The Panel also found that, in the absence of any evidence or arguments that "urgent problems of safety, health, environmental protection or national security" arose or threatened to arise upon adoption of Section 907(a)(1)(A), Article 2.10 of the *TBT Agreement* would not be applicable to the present dispute.<sup>14</sup> Finally, the Panel found that Indonesia failed to demonstrate that the United States had acted inconsistently with Article 12.3 of the *TBT Agreement* by failing to take account of the special development, financial, and trade needs of Indonesia in the preparation and application of Section 907(a)(1)(A).<sup>15</sup>

7. Accordingly, the Panel recommended that the Dispute Settlement Body (the "DSB") request the United States to bring Section 907(a)(1)(A) into conformity with its obligations under Articles 2.1, 2.9.2, and 2.12 of the *TBT Agreement*.<sup>16</sup>

8. On 5 January 2012, the United States notified the DSB of its intention to appeal certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel, pursuant to Articles 16.4 and 17 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), and filed a Notice of Appeal<sup>17</sup> and an appellant's submission pursuant to Rules 20 and 21, respectively, of the *Working Procedures for Appellate Review*<sup>18</sup> (the "*Working Procedures*"). On 23 January 2012, Indonesia filed an appellee's submission.<sup>19</sup> On 26 January 2012, Brazil, Colombia, the European Union, Mexico, Norway, and Turkey each filed a third participant's submission.<sup>20</sup> On the same date, the Dominican Republic and Guatemala notified their intention to appear at the oral hearing as third participants.<sup>21</sup>

9. On appeal, the United States claims that the Panel erred in finding that the United States acted inconsistently with Article 2.1 of the *TBT Agreement*. In particular, the United States claims that the Panel erred in finding that imported clove cigarettes and domestic menthol cigarettes were like products within the meaning of Article 2.1. The United States also challenges the Panel's finding that Section 907(a)(1)(A) accords to imported clove cigarettes less favourable treatment than that accorded to domestic like products. The United States claims further that the Panel acted inconsistently with Article 11 of the DSU in reaching these findings. The United States also claims that the Panel erred in finding that the United States acted inconsistently with Article 2.12 of the *TBT Agreement* by not

<sup>13</sup>Panel Report, paras. 7.549, 7.551, and 8.1(g).

<sup>14</sup>Panel Report, para. 7.507.

<sup>15</sup>Panel Report, paras. 7.649 and 8.1(i).

<sup>16</sup>Panel Report, para. 8.6.

<sup>17</sup>WT/DS406/6 (attached as Annex I to this Report).

<sup>18</sup>WT/AB/WP/6, 16 August 2010.

<sup>19</sup>Pursuant to Rule 22 of the *Working Procedures*.

<sup>20</sup>Pursuant to Rule 24(1) of the *Working Procedures*.

<sup>21</sup>Pursuant to Rule 24(2) of the *Working Procedures*.

allowing an interval of no less than six months between the publication and the entry into force of Section 907(a)(1)(A). The United States conditionally appeals the Panel's reliance on the jurisprudence developed under Article XX(b) of the GATT 1994 in its assessment of Indonesia's claims under Article 2.2, should Indonesia appeal the Panel's finding that the United States did not act inconsistently with Article 2.2 of the *TBT Agreement*. Indonesia did not raise an other appeal of any issues under Article 2.2 of the *TBT Agreement*. Therefore, the condition on which the United States bases its appeal of the Panel's findings under Article 2.2 is not met.

10. Two *amicus curiae* briefs were received by the Appellate Body in relation to this appeal: on 24 January 2012 from the Campaign for Tobacco-Free Kids, the American Academy of Pediatrics, the American Cancer Society, the American Cancer Society Cancer Action Network, the American Lung Association, the American Medical Association, and the American Public Health Association; and on 26 January 2012 from the O'Neill Institute for National and Global Health Law at the Georgetown University Law Center. The Appellate Body Division hearing the appeal gave the participants and third participants an opportunity to express their views on the *amicus curiae* briefs referred to above. The Division did not find it necessary to rely on these *amicus curiae* briefs in rendering its decision.

11. On 25 January 2012, the Presiding Member of the Division received a letter from the Director-General of the World Health Organization (the "WHO") expressing interest and offering technical assistance in this appeal in areas covered by the WHO's mandate. The Division thanked the WHO Director-General for her letter, and indicated that it would reflect on the need for such assistance. The Division asked the participants and third participants to comment on the letter from the WHO. Of the participants, the United States submitted comments, and of the third participants, the European Union commented. In the light of the fact that the parties had placed a considerable amount of materials regarding WHO legal instruments and the WHO's work in the area of tobacco control on the Panel record, and mindful of its mandate on appeal under Article 17.6 of the DSU, the Division did not deem it necessary to request assistance from the WHO.

12. The oral hearing in this appeal was held on 9 and 10 February 2012. The participants and six of the third participants (Brazil, Colombia, Guatemala, Mexico, Norway, and Turkey) made oral opening statements. The participants and third participants subsequently responded to questions posed by the Members of the Division hearing the appeal.

## II. Arguments of the Participants and the Third Participants

### A. *Claims of Error by the United States – Appellant*

#### 1. Article 2.1 of the *TBT Agreement* – "Like Products"

13. The United States claims on appeal that the Panel erred in its interpretation and specific application of the term "like products" under Article 2.1 of the *TBT Agreement*, and requests the Appellate Body to reverse the Panel's findings in this respect. In particular, while agreeing with the overall approach adopted by the Panel in its like product analysis—that is, one that determines likeness based on the traditional "likeness" criteria, and in the light of the legal provision at issue and of the public health nature of the measure being challenged<sup>22</sup>—the United States contends that the Panel conducted an "incomplete and flawed" analysis with respect to two of the traditional "likeness" criteria, namely, end-uses and consumer tastes and habits.<sup>23</sup>

#### (a) End-Uses

14. The United States claims that the Panel erred by failing to perform a complete analysis of the different end-uses of clove and menthol cigarettes and by concluding that the end-use for both products is "to be smoked".<sup>24</sup> In the United States' view, the Panel improperly dismissed the possible different end-uses presented by the United States—that is, satisfying an addiction to nicotine, and creating a pleasurable experience associated with the taste of the cigarette and aroma of the smoke<sup>25</sup>—and erroneously based its ultimate conclusion on an "overly narrow analysis".<sup>26</sup>

15. The United States submits that a panel, when conducting an end-use analysis, must consider the different uses of the products in question and not just the use that is a "common denominator" between the products. In this regard, the United States relies on statements of the Appellate Body in *EC – Asbestos* that "a panel must also examine the other, *different* end-uses for products" and that "[i]t is only by forming a complete picture of the various end-uses of a product that a panel can assess the significance of the fact that products share a limited number of end-uses."<sup>27</sup> According to the United States, it is undisputed that both clove and menthol cigarettes are used for smoking, but the Panel improperly limited its analysis to considering only such common use between the products while ignoring other relevant end-uses. Menthol cigarettes, the United States posits, are used to

<sup>22</sup>United States' appellant's submission, paras. 37 and 41.

<sup>23</sup>United States' appellant's submission, para. 42.

<sup>24</sup>United States' appellant's submission, para. 43 (quoting Panel Report, para. 7.199).

<sup>25</sup>United States' appellant's submission, para. 44.

<sup>26</sup>United States' appellant's submission, para. 45.

<sup>27</sup>United States' appellant's submission, para. 45 (quoting Appellate Body Report, *EC – Asbestos*, para. 119 (original emphasis)).

"satisfy the nicotine addictions of millions of smokers in the United States", whereas clove cigarettes are primarily used "for experimentation and special social settings" and generally are not smoked to satisfy nicotine addiction in the US market.<sup>28</sup>

16. The United States further takes issue with the Panel's rejection of the different end-uses of clove and menthol cigarettes based on the argument that these end-uses are related to the reasons why a person might smoke a cigarette, and maintains that the Panel erred in finding that end-uses and consumer tastes and habits are "mutually exclusive concepts".<sup>29</sup> Referring to the Appellate Body report in *EC – Asbestos*, the United States notes that, although consumer tastes and habits constitute a "likeness" criterion separate from end-uses, consumer preferences are nonetheless relevant to how products are capable of being used.<sup>30</sup> However, the United States contends that the Panel incorrectly considered end-uses "absent the relevant, real-world context"<sup>31</sup> of how the products at issue are used in the relevant market. Clove and menthol cigarettes have different and "multi-faceted" end-uses—that is, "habitual use and satisfying addiction versus occasional, experimental use"<sup>32</sup>—which cannot, in the United States' view, be reduced to the simple, undisputed fact that both types of cigarettes are used for smoking. This is particularly true, the United States adduces, where the public health context relates to the different ways in which cigarettes are used in the relevant market. According to the United States, the Panel erred by failing to consider the "complete picture" and by disregarding evidence relating to such differences in use.<sup>33</sup>

(b) Consumer Tastes and Habits

17. The United States claims that the Panel failed to perform a complete analysis of consumer tastes and habits related to clove and menthol cigarettes. In the United States' view, the Panel first made a legal error by excluding the tastes and habits of current adult consumers from its analysis. The United States further contends that the Panel acted inconsistently with Article 11 of the DSU by refusing to examine evidence on how consumers in the relevant market use clove and menthol cigarettes.<sup>34</sup>

18. First, the United States maintains that the Panel erred in determining that it need not examine the tastes and habits of current adult consumers as part of its analysis. In the United States' view, by disregarding how current consumers perceive and use the products at issue, the Panel erroneously

<sup>28</sup>United States' appellant's submission, para. 46.

<sup>29</sup>United States' appellant's submission, para. 48.

<sup>30</sup>United States' appellant's submission, para. 47 (quoting Appellate Body Report, *EC – Asbestos*, para. 102).

<sup>31</sup>United States' appellant's submission, para. 48.

<sup>32</sup>United States' appellant's submission, para. 49.

<sup>33</sup>United States' appellant's submission, para. 49.

<sup>34</sup>United States' appellant's submission, para. 50.

limited the scope of consumer tastes and habits to one aspect of the public health basis for Section 907(a)(1)(A) of the FDCA—use by young people—and failed to capture the other aspect—use by adult smokers—thereby nullifying consumer tastes and habits as a meaningful criterion.<sup>35</sup> Consistent with the principle stated by the Appellate Body in *EC – Asbestos*, the Panel was required to examine evidence related to each of the criteria set forth in the GATT Working Party report in *Border Tax Adjustments*, and to weigh "all of the relevant evidence".<sup>36</sup> Accordingly, the United States claims that the Panel committed a fundamental error in excluding, *a priori*, an essential element from the analysis of consumer tastes and habits.<sup>37</sup>

19. Moreover, the United States posits that, given the particular nature of this dispute, the tastes and habits of current adult consumers are highly relevant. First, Section 907(a)(1)(A) draws regulatory distinctions among cigarettes based not only on their appeal to potential smokers, but based on their uses by current adult smokers as well. Banning cigarettes that are used by adults on a regular basis entails a risk of "straining the healthcare system or exacerbating the illicit market".<sup>38</sup> Second, clove and other banned flavoured cigarettes are used in very small numbers and almost exclusively by young people, thus being "trainer" or "starter" cigarettes, whereas menthol cigarettes are consumed by 20 to 26 per cent of adult smokers in the United States.<sup>39</sup> Consequently, the United States argues, the products at issue pose different public health challenges: clove cigarettes present a unique risk to young, uninitiated smokers, while menthol cigarettes also have a significant impact on adults.<sup>40</sup> Finally, the particular flavour matters, in the sense that adult smokers seldom use clove-flavoured cigarettes and do not perceive them to be like menthol cigarettes.<sup>41</sup>

20. The United States further claims that the exclusion of current adult consumer tastes and habits cannot be justified by the Panel's finding on the declared legitimate objective of Section 907(a)(1)(A) to prevent new young smokers from becoming addicted to cigarettes.<sup>42</sup> Albeit agreeing with the Panel that the characteristics of the products at issue must be examined in the light of the public health basis of the measure at issue<sup>43</sup>, the United States contends that there is no textual basis in Article 2.1 of the *TBT Agreement* to limit the consideration of the public health distinctions to the immediate

<sup>35</sup>United States' appellant's submission, para. 58.

<sup>36</sup>United States' appellant's submission, para. 56 (quoting Appellate Body Report, *EC – Asbestos*, paras. 109 (in turn referring to GATT Working Party Report, *Border Tax Adjustments*) and 113 (original emphasis)).

<sup>37</sup>United States' appellant's submission, para. 53.

<sup>38</sup>United States' appellant's submission, para. 54.

<sup>39</sup>United States' appellant's submission, para. 58 (referring to Panel Report, paras. 2.24, 2.25, and 7.391).

<sup>40</sup>United States' appellant's submission, para. 55.

<sup>41</sup>United States' appellant's submission, para. 58.

<sup>42</sup>United States' appellant's submission, para. 59 (referring to Panel Report, paras. 7.116, 7.119, 7.201, and 7.206).

<sup>43</sup>United States' appellant's submission, para. 59 (referring to Panel Report, paras. 7.245-7.249).

objective of the measure.<sup>44</sup> Rather, technical regulations inevitably reflect a balancing of other considerations relevant to public welfare—in this case, the additional health concerns associated with heavily used cigarettes, such as possible increases in unregulated black market cigarettes or strain on the healthcare system.<sup>45</sup> The United States submits that the Panel based its exclusion of current adult consumers on a narrow view of the measure's objective, which was actually targeting a group of tobacco products "that *uniquely* appeal to youth" without precluding access by adults to those cigarettes that are "most heavily used in the U.S. market".<sup>46</sup> Even assuming that the Panel was correct to limit its assessment of the product distinctions on the basis of the primary legitimate objective of Section 907(a)(1)(A)—that is, the "reduction of youth smoking"—the United States contends that, precisely because of the measure's distinction between adult and youth smoking behaviour, the Panel was required to take into account the comparative patterns of use in the relevant market.<sup>47</sup>

21. Second, the United States claims that the Panel acted inconsistently with Article 11 of the DSU by disregarding critical evidence on how consumers use and perceive the products<sup>48</sup>, and thereby came to a "fatally flawed" conclusion on consumer tastes and habits.<sup>49</sup> In the United States' view, the Panel improperly disregarded critical survey evidence submitted by both parties on the basis that it was not clear and that the information presented therein was "not directly comparable", without duly examining such evidence according to its probative force.<sup>50</sup> According to the United States, the survey data were particularly relevant because the data provided evidence on how consumers and potential consumers "used and perceived different cigarettes in the United States".<sup>51</sup> In addition, the United States argues that the Panel based its conclusions entirely on speculation and conjecture, without any evidentiary support on the record, and ultimately concluded that, for potential consumers, arguably, "any cigarette would likely be fine to start smoking".<sup>52</sup> However, the United States submits, the reports used as evidence by the Panel "do not tell the whole story", because they focus on cigarettes with characterizing flavours, but do not present the whole picture as to how cigarettes actually are used and perceived in the United States, the relevant market in this dispute.<sup>53</sup> According

<sup>44</sup>United States' appellant's submission, para. 60 (referring to Panel Report, para. 7.116).

<sup>45</sup>United States' appellant's submission, para. 61.

<sup>46</sup>United States' appellant's submission, para. 61. (original emphasis)

<sup>47</sup>United States' appellant's submission, para. 63.

<sup>48</sup>United States' appellant's submission, para. 64.

<sup>49</sup>United States' appellant's submission, para. 68.

<sup>50</sup>United States' appellant's submission, para. 67 (quoting Panel Report, para. 7.210). The United States also stresses that, in the section of the Panel Report devoted to its analysis under Article 2.2 of the *TBT Agreement*, the Panel did rely upon the information provided in the surveys on market share. (*Ibid.*, para. 66)

<sup>51</sup>United States' appellant's submission, para. 67. (original emphasis)

<sup>52</sup>United States' appellant's submission, para. 68 (quoting Panel Report, para. 7.214).

<sup>53</sup>United States' appellant's submission, para. 69 (referring to United States' response to Panel Question 44, para. 110; and Indonesia's response to Panel Question 44, para. 97).

to the United States, the handling of the evidence by the Panel falls short of an objective assessment of the facts and is therefore incompatible with the Panel's duty under Article 11 of the DSU.<sup>54</sup>

2. Article 2.1 of the TBT Agreement – "Treatment No Less Favourable"

22. The United States claims that the Panel erred in finding that Section 907(a)(1)(A) of the FFDCA accords to imported clove cigarettes less favourable treatment than that accorded to like domestic products, and requests the Appellate Body to reverse this finding. The United States also requests the Appellate Body to find that the Panel acted inconsistently with Article 11 of the DSU when it found: (i) that there were no domestic cigarettes with characterizing flavours other than menthol at the time of the ban; and (ii) that Section 907(a)(1)(A) imposes no costs on any US entity.

23. First, the United States argues that the Panel erroneously limited the scope of the products to be compared for the purposes of its less favourable treatment analysis to one banned imported product—Indonesian clove cigarettes—and one non-banned like domestic product—menthol cigarettes—thereby reaching the "flawed conclusion" that Indonesian clove cigarettes are treated less favourably than like domestic products.<sup>55</sup> Referring to the Appellate Body report in *EC – Asbestos*, the United States posits that "the relevant analysis is how the measure treats like imported products, as a group, and like domestic products, as a group".<sup>56</sup> Accordingly, the Panel was required to consider the "treatment of all domestic and imported cigarettes with characterizing flavors".<sup>57</sup> However, in the United States' view, the Panel improperly excluded, with respect to like domestic products, the treatment accorded by the measure to domestic cigarettes with other characterizing flavours and, with respect to like imported products, the treatment accorded to menthol cigarettes from other countries.<sup>58</sup> According to the United States, a proper less favourable treatment analysis that considers all cigarettes that meet the criteria of "like products" demonstrates that Section 907(a)(1)(A) bans only products comprising "a very small market segment in the United States", and "does not alter the conditions of competition" as between like imported products, as a group, and like domestic products, as a group.<sup>59</sup>

24. For the United States, the reference to treatment accorded to the products imported from the territory of "*any other Member*" in Article 2.1 does not compel the conclusion that only the treatment

<sup>54</sup>United States' appellant's submission, para. 69 (quoting Appellate Body Report, *EC – Hormones*, para. 133).

<sup>55</sup>United States' appellant's submission, para. 74.

<sup>56</sup>United States' appellant's submission, para. 75 (referring to Appellate Body Report, *EC – Asbestos*, para. 100). See also Panel Report, *US – Tuna II (Mexico)*, para. 7.295.

<sup>57</sup>United States' appellant's submission, para. 77. (original underlining). Albeit disagreeing with the Panel's conclusion that clove and menthol cigarettes are like products, the United States stresses that "other cigarettes with characterizing flavors ... would meet the Panel's criteria and thus belong to the category of cigarettes deemed by the Panel to be like products." (*Ibid.*, para. 78 (referring to Panel Report, para. 7.247))

<sup>58</sup>United States' appellant's submission, para. 79.

<sup>59</sup>United States' appellant's submission, paras. 80 and 81. (original underlining)

accorded to the complaining Member's products are relevant.<sup>60</sup> In the United States' view, the main purpose of a *de facto* less favourable treatment analysis is to assess whether Section 907(a)(1)(A) legitimately draws distinctions among like products or whether it creates "a proxy for singling out the like products of the complaining Member for less favorable treatment".<sup>61</sup> In order to make such an assessment, the analysis should consider the entire range of like products addressed by the measure. The question of less favourable treatment is not answered by the sole fact that clove cigarettes were banned while a single like domestic product (menthol cigarettes) was not. In this case, the United States contends that the ban affected some imported and domestic products, but "did not affect other domestic and imported like products".<sup>62</sup>

25. In addition, to the extent that the Panel took the view that it was limited by its terms of reference to consider only the products mentioned in Indonesia's request for the establishment of a panel<sup>63</sup>, the United States claims that the Panel erred in concluding that Indonesia, as the complaining party, "set the field of products to be compared"<sup>64</sup>—that is, "imported clove cigarettes *versus* domestic menthol cigarettes".<sup>65</sup> While defining which measures and claims a panel may consider, the terms of reference do not define the scope of the relevant products to analyze with respect to a discrimination claim, nor do they limit which defences a responding party may invoke.<sup>66</sup> The United States notes that the question of which products should be compared in the less favourable treatment analysis was a point of argument between the parties in the present dispute, and stresses that the complainant cannot *a priori* limit the scope of the comparison by its selection of products in its panel request.

26. Second, the United States takes issue with the Panel's statement that, "at the time of the ban, there were no domestic cigarettes with characterizing flavours other than menthol."<sup>67</sup> The United States submits that such a statement reflects a "mis-application of the legal standard" under Article 2.1 of the *TBT Agreement*.<sup>68</sup> The Panel "improperly restrict[ed] the legal analysis" when it limited the comparison to only products that were on the market at the time the ban went into effect, without regard to the years preceding or forthcoming. Article 2.1 of the *TBT Agreement* does not contain any "rigid temporal limitation" to the evidence a panel may consider in conducting a less

<sup>60</sup>United States' appellant's submission, para. 84 (referring to Panel Report, para. 7.275).

<sup>61</sup>United States' appellant's submission, para. 84.

<sup>62</sup>United States' appellant's submission, para. 85. (original underlining)

<sup>63</sup>Request for the Establishment of a Panel by Indonesia, WT/DS406/2.

<sup>64</sup>United States' appellant's submission, para. 87.

<sup>65</sup>United States' appellant's submission, para. 86 (quoting Panel Report, para. 7.147 (original emphasis)).

<sup>66</sup>United States' appellant's submission, para. 87.

<sup>67</sup>United States' appellant's submission, para. 90 (quoting Panel Report, para. 7.289).

<sup>68</sup>United States' appellant's submission, para. 91.

favourable treatment analysis.<sup>69</sup> Therefore, the Panel should have taken into account the fact that there were domestic cigarettes with characterizing flavours other than menthol in the years preceding the effective date of the ban.<sup>70</sup> Moreover, the Panel incorrectly dismissed the fact that Section 907(a)(1)(A) was enacted specifically "to respond to an *emerging* trend of products" that US producers "were actively exploring".<sup>71</sup> In that respect, the United States stresses that the focus of Section 907(a)(1)(A) was "primarily U.S. production", and that it is not unusual that producers will stop investing in products "even before the ban goes into effect". This should not be construed, however, as evidence that US production "was not affected".<sup>72</sup>

27. Third, the United States claims that the Panel failed to make an objective assessment of the facts, in violation of Article 11 of the DSU, by ignoring un rebutted evidence showing that cigarettes with characterizing flavours other than menthol were marketed in the United States at the time of the ban. The facts on record do not support the Panel's finding that there were no domestically produced flavoured cigarettes—other than menthol—at the time of the ban. In particular, the United States recalls that the Panel had already found that: (i) there was at least one domestically produced brand of clove cigarettes on the market prior to the ban<sup>73</sup>; (ii) the list of cigarettes authorized for sale in 2008 and 2009 in several US states included at least 20 different brands of domestic flavoured cigarettes other than menthol; and (iii) by 2008, just one year before the ban went into effect, at least four US companies were producing flavoured cigarettes.<sup>74</sup>

28. Fourth, the United States claims that the Panel erred in concluding that any detriment to the competitive conditions for clove cigarettes in the US market could not be explained by factors unrelated to the foreign origin of the products. Even assuming *arguendo* that the Panel had properly identified the like imported and domestic products to be compared, its analysis of whether the less favourable treatment accorded to clove cigarettes was related to the origin of the imported products was in error.<sup>75</sup>

<sup>69</sup>United States' appellant's submission, para. 91.

<sup>70</sup>United States' appellant's submission, para. 92 (referring to Indonesia's first written submission to the Panel, footnote 29 to para. 22; United States' first written submission to the Panel, para. 51; ACNielsen 2008 Data on Flavoured Cigarettes in the United States (Panel Exhibit US-52); Examples of Cigarettes Certified for Sale in the United States as of 2009 (Panel Exhibit US-62); New York List of Fire-Safe Certified Cigarettes as of 20 January 2009 (Panel Exhibit US-63); and Maine List of Fire-Safe Certified Cigarettes as of 29 July 2009 (Panel Exhibit US-64)).

<sup>71</sup>United States' appellant's submission, para. 93. (original emphasis)

<sup>72</sup>United States' appellant's submission, para. 94.

<sup>73</sup>United States' appellant's submission, para. 97 (referring to Panel Report, para. 2.27).

<sup>74</sup>United States' appellant's submission, paras. 97 and 98 (quoting Panel Report, paras. 2.27, 2.28, and footnote 524 to para. 7.289, in turn quoting Panel Exhibits US-52 and US-62 (*supra*, footnote 70)).

<sup>75</sup>United States' appellant's submission, para. 99.

29. For the United States, under Article 2.1 of the *TBT Agreement*, a technical regulation may impose costs or burdens associated with imported products as compared to like domestic products without necessarily according less favourable treatment to the imported product, where these burdens are explained by a factor or circumstance other than the origin of the products.<sup>76</sup> In this regard, the United States stresses that there are a number of prior WTO reports in which a detrimental effect on an imported product was not related to its origin, but rather to other factors—such as the product's particular market share or import profile, a difference in the real or perceived safety of the products at issue, or the choices of the producers themselves, as private actors.<sup>77</sup> According to the United States, the Panel failed to consider any arguments or evidence bearing upon other relevant factors (unrelated to origin) that could have explained the detriment to the competitive situation of imported clove cigarettes.<sup>78</sup>

30. In the United States' view, in finding that the reason for excluding menthol cigarettes from the ban under Section 907(a)(1)(A) related to "the costs that might be incurred by the United States were it to ban menthol cigarettes"<sup>79</sup>, the Panel failed to examine whether the detriment to the competitive situation of clove cigarettes was related to their origin.<sup>80</sup> Besides the fact that "it is unclear" what the Panel meant by "costs", the United States submits that the text of Article 2.1 requires panels to focus on the comparative treatment of products. Therefore, Article 2.1 contains "no basis" for a comparison of costs imposed on foreign producers with those avoided by "any U.S. entity".<sup>81</sup> In any case, the United States posits, the Panel's finding does not show that any detrimental effect to the competitive conditions for clove cigarettes compared to menthol cigarettes was related to the national origin of imported products. In fact, the costs incurred by the United States if it were to ban menthol cigarettes—that is, "the potential impact on the health care system and the potential development of a black market and smuggling of menthol cigarettes"<sup>82</sup>—would remain unaltered regardless of where menthol cigarettes were produced, and even if all menthol cigarettes were imported.<sup>83</sup>

<sup>76</sup>United States' appellant's submission, para. 101 (referring to Panel Report, para. 7.269; Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 96; and United States' second written submission to the Panel, paras. 137-144).

<sup>77</sup>United States' appellant's submission, para. 102 (referring to Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 96; Panel Report, *EC – Approval and Marketing of Biotech Products*, para. 7.2514; Panel Report, *US – Tuna II (Mexico)*, paras. 7.331, 7.332, and 7.340; and United States' second written submission to the Panel, paras. 138 and 140).

<sup>78</sup>United States' appellant's submission, paras. 103 and 104.

<sup>79</sup>United States' appellant's submission, para. 105 (quoting Panel Report, para. 7.289).

<sup>80</sup>United States' appellant's submission, para. 105.

<sup>81</sup>United States' appellant's submission, para. 106.

<sup>82</sup>United States' appellant's submission, para. 107 (quoting Panel Report, para. 7.289).

<sup>83</sup>United States' appellant's submission, para. 107.

31. In addition, the United States claims that the Panel acted inconsistently with its duties under Article 11 of the DSU by finding, without an appropriate evidentiary basis<sup>84</sup>, that Section 907(a)(1)(A) does not impose "any costs on any U.S. entity".<sup>85</sup> The United States recalls that Article 11 requires a panel to refrain from issuing "affirmative findings that lack a basis in the evidence contained in the panel record".<sup>86</sup> In this dispute, the United States posits, there was no basis for the Panel to conclude that the measure avoids costs to any US entity, as underscored by the fact that the Panel "barely cited the record".<sup>87</sup> According to the United States, the Panel ignored the fact that the United States Food and Drug Administration (the "FDA") was charged with enforcing the measure, thereby incurring "costs" as a US entity.<sup>88</sup> Moreover, the Panel did not take into account that the effect of the measure on US production was "pre-emptive and closed off a potential market that U.S. producers were actively exploring", nor did it consider that, by reducing youth smoking, Section 907(a)(1)(A) reduces demand for all cigarettes and thus "shrinks the U.S. adult cigarette market".<sup>89</sup>

3. Article 2.12 of the TBT Agreement – "Reasonable Interval"

32. The United States claims that the Panel's analysis under Article 2.12 of the *TBT Agreement* contains three errors that led it to find, incorrectly, that the United States acted inconsistently with Article 2.12. First, the United States argues that the Panel attributed an incorrect "interpretative value" to the Doha Ministerial Decision on Implementation-Related Issues and Concerns<sup>90</sup> (the "Doha Ministerial Decision") in interpreting the meaning of Article 2.12. Second, the United States argues that the Panel incorrectly found that Indonesia had established a *prima facie* case of inconsistency with Article 2.12. Lastly, the United States argues that, regardless of whether the Panel was correct in finding that Indonesia had established a *prima facie* case of inconsistency with Article 2.12, the Panel incorrectly determined that the United States did not rebut Indonesia's arguments.<sup>91</sup>

33. The United States first claims that the Panel attributed an incorrect "interpretative value" to paragraph 5.2 of the Doha Ministerial Decision by treating paragraph 5.2 as though it were an authoritative interpretation adopted by the Ministerial Conference pursuant to Article IX:2 of the *Marrakesh Agreement Establishing the World Trade Organization* (the "*WTO Agreement*"), despite not having found that it has this legal status. The United States further argues that the legal value of

<sup>84</sup>United States' appellant's submission, para. 113.

<sup>85</sup>United States' appellant's submission, para. 109. (original emphasis)

<sup>86</sup>United States' appellant's submission, para. 110 (quoting Appellate Body Report, *Canada – Wheat Exports and Grain Imports*, para. 181).

<sup>87</sup>United States' appellant's submission, para. 110.

<sup>88</sup>United States' appellant's submission, para. 110.

<sup>89</sup>United States' appellant's submission, para. 111.

<sup>90</sup>Decision of 14 November 2011, WT/MIN(01)/17.

<sup>91</sup>United States' appellant's submission, para. 123.

paragraph 5.2 of the Doha Ministerial Decision is, at most, a "means of supplemental interpretation" under Article 32 of the *Vienna Convention on the Law of Treaties*<sup>92</sup> (the "*Vienna Convention*").<sup>93</sup> Therefore, while paragraph 5.2 of the Doha Ministerial Decision may be used to confirm the meaning of the term "reasonable interval" in Article 2.12 of the *TBT Agreement*, it may not be applied as a "rule" that can be relied upon as the exclusive basis for concluding that the term "reasonable interval" means "not less than six months".<sup>94</sup>

34. According to the United States, the Doha Ministerial Decision "preceded by several months"<sup>95</sup> a TBT Committee decision that took note of paragraph 5.2 of the Doha Ministerial Decision and, therefore, the Ministerial Conference could not have acted on a recommendation of the Council for Trade in Goods, as Article IX:2 of the *WTO Agreement* requires for the adoption of multilateral interpretations of agreements contained in Annex 1 to the *WTO Agreement*.

35. Second, the United States claims that the Panel incorrectly found that Indonesia had established a *prima facie* case of inconsistency with Article 2.12 where it did not establish that the interval period was unreasonable in the light of the impact on the ability of exporting Members to adapt to the requirements of Section 907(a)(1)(A) of the FFDCA.<sup>96</sup> The United States submits that Indonesia never provided any evidence or legal argument that demonstrates that the three-month period allowed by the United States prejudiced the ability of any foreign producer, including Indonesian producers, to adapt to the requirements of Section 907(a)(1)(A).<sup>97</sup>

36. The United States argues further that, "[e]ven assuming *arguendo* that the Panel was correct in deciding that the elements of the *prima facie* case could be drawn exclusively from paragraph 5.2", the Panel erred in finding that Indonesia had succeeded in establishing a *prima facie* case under the terms of that paragraph<sup>98</sup>, because Indonesia would have had to establish "with evidence and argument" that Section 907(a)(1)(A) presents a "normal" situation and does not constitute one of the non-urgent cases where it would be reasonable to have a shorter interval.<sup>99</sup> The United States submits that Indonesia would also have had to establish that "allowing an interval period of at least six months would not render the fulfillment of the objective pursued by Section 907(a)(1)(A) ineffective".<sup>100</sup>

<sup>92</sup>Done at Vienna, 23 May 1969, 1155 UNTS 331; 8 International Legal Materials 679.

<sup>93</sup>United States' appellant's submission, para. 126.

<sup>94</sup>United States' appellant's submission, para. 126 (quoting Panel Report, para. 7:559). (footnote omitted)

<sup>95</sup>United States' appellant's submission, para. 125.

<sup>96</sup>United States' appellant's submission, para. 131.

<sup>97</sup>United States' appellant's submission, para. 133.

<sup>98</sup>United States' appellant's submission, para. 135.

<sup>99</sup>United States' appellant's submission, paras. 135 and 138.

<sup>100</sup>United States' appellant's submission, para. 136.

37. According to the United States, the Panel based its finding that Indonesia had established a *prima facie* case entirely on a "single" statement made by Indonesia that "neither the Act itself nor any other statement by the United States indicates that having [Section 907(a)(1)(A)] enter into force 90 days after signing was necessary to fulfill the objectives of the Act".<sup>101</sup> According to the United States, "Indonesia's assertion does not demonstrate what the Panel claimed Indonesia needed to prove—that a six month interval period would be effective in fulfilling the legitimate objective of Section 907(a)(1)(A)".<sup>102</sup>

38. Third, the United States claims that, even if Indonesia did establish a *prima facie* case, the Panel improperly found that the United States did not rebut that *prima facie* case. According to the United States, "no matter what weight"<sup>103</sup> is attributed to the Doha Ministerial Decision, Indonesia was required to establish a *prima facie* case under the terms of Article 2.12 of the *TBT Agreement*. In the United States' view, the evidence and argument before the Panel on whether the interval period chosen allowed time for Indonesian producers to adapt their products to the requirements of Section 907(a)(1)(A) showed that "the difference between the three and six month interval periods had no impact on Indonesian producers".<sup>104</sup> According to the United States, the fact that "Indonesian producers, even 16 months after the enactment of the FSPTCA, had not adjusted their product lines to produce tobacco or menthol-flavoured cigarettes"<sup>105</sup> is sufficient evidence to rebut the *prima facie* case that the Panel found Indonesia to have established. Accordingly, the Panel committed legal error in finding that "the United States has not rebutted" Indonesia's *prima facie* case.<sup>106</sup>

#### B. *Arguments of Indonesia – Appellee*

##### 1. Article 2.1 of the *TBT Agreement* – "Like Products"

39. Indonesia requests the Appellate Body to reject the United States' appeal against the Panel's finding that clove and menthol cigarettes are like products within the meaning of Article 2.1 of the *TBT Agreement*. In Indonesia's view, the United States' objection is not about the legal findings of the Panel, but about the appropriate weight to give to certain evidence and findings of fact. According to Indonesia, in many of its claims, the United States is simply attempting to disguise its disagreement with the Panel's findings of fact as legal error.<sup>107</sup> Indonesia also recalls that the United States did not

<sup>101</sup>United States' appellant's submission, para. 147 (quoting Panel Report, para. 7:587, in turn quoting Indonesia's first written submission to the Panel, para. 145).

<sup>102</sup>United States' appellant's submission, para. 149. (footnote omitted)

<sup>103</sup>United States' appellant's submission, para. 132.

<sup>104</sup>United States' appellant's submission, para. 152. (original emphasis)

<sup>105</sup>United States' appellant's submission, para. 152 (quoting Panel Report, para. 7:583).

<sup>106</sup>United States' appellant's submission, para. 153 (quoting Panel Report, para. 7:594).

<sup>107</sup>Indonesia's appellee's submission, para. 65.

appeal the Panel's conclusion that clove and menthol cigarettes share similar physical characteristics.<sup>108</sup>

(a) End-Uses

40. Indonesia takes issue with the United States' contention that the Panel "over-simplified" its analysis in finding that the end-use of both products at issue is "to be smoked".<sup>109</sup> In Indonesia's view, the United States' claim that clove and menthol cigarettes have different end-uses because clove cigarettes are smoked only occasionally while menthol cigarettes are used regularly by addicted smokers has no merit and should be rejected by the Appellate Body. At the outset, Indonesia recalls that, in *Philippines – Distilled Spirits*, the United States correctly noted that "there is no support for the [ ] proposition that a product consumed on special occasions cannot be in competition with a routinely purchased product".<sup>110</sup>

41. Indonesia first submits that the Panel examined end-uses pursuant to prior guidance from the Appellate Body. In particular, in accordance with the Appellate Body's guidance in *EC – Asbestos*, the Panel noted that the definition of "end-uses" is "the extent to which two products are *capable of performing the same function*".<sup>111</sup> According to Indonesia, in its finding with respect to end-uses, the Panel also properly gave special consideration to the fact that Section 907(a)(1)(A) of the FFDCRA is a public health measure aimed at addressing youth smoking. In Indonesia's view, moreover, even assuming *arguendo* that the end-uses put forward by the United States were pertinent ones, the United States presented no evidence showing that clove and menthol cigarettes were not both capable of performing the end-uses of satisfying a nicotine addiction and creating a pleasurable experience.<sup>112</sup> In addition, Indonesia contends that the Panel did not dismiss out-of-hand the possibility that products may have more than one end-use, but rather simply concluded that the products at issue in the present case did not have the specific end-uses suggested by the United States.<sup>113</sup>

42. Second, Indonesia submits that the Panel did not ignore the alternative end-uses for the products at issue proposed by the United States, but rather went to great lengths to consider the evidence regarding end-uses, including those additional end-uses put forth by the United States. According to Indonesia, the Panel addressed the question of whether "regular use" is different from "occasional use", and carefully laid out in its Report the United States' argument that delivering

<sup>108</sup>Indonesia's appellee's submission, para. 66.

<sup>109</sup>Indonesia's appellee's submission, para. 67.

<sup>110</sup>Indonesia's appellee's submission, para. 68 (quoting Appellate Body Reports, *Philippines – Distilled*

*Spirits*, para. 71).

<sup>111</sup>Indonesia's appellee's submission, para. 71 (referring to Panel Report, para. 7.191, in turn referring to Appellate Body Report, *EC – Asbestos*, para. 117) (original emphasis)

<sup>112</sup>Indonesia's appellee's submission, para. 73.

<sup>113</sup>Indonesia's appellee's submission, para. 74 (referring to Panel Report, para. 7.198).

nicotine to addicted smokers must be considered as a separate end-use. However, the Panel eventually found that the United States' argument on end-uses was "circular".<sup>114</sup> Indeed, Indonesia argues, the Panel simply was not persuaded by the merits of the argument of the United States<sup>115</sup> and proceeded to conclude—based on evidence showing that both clove and menthol cigarettes were capable of delivering nicotine<sup>116</sup>—that the end-use of both types of cigarettes was "to be smoked".<sup>117</sup> Although the United States asserted that there was an "occasional"-use cigarette market, it provided little evidence in support of this claim.<sup>118</sup> Accordingly, Indonesia submits that the Panel did not commit errors of law or fail to make an objective assessment of the evidence, and requests the Appellate Body to uphold the Panel's conclusion that clove and menthol cigarettes share the same end-use of "being smoked".<sup>119</sup>

(b) Consumer Tastes and Habits

43. Indonesia first submits that the Panel did not commit a legal error in its analysis of consumer tastes and habits, but rather conducted a thorough analysis, acted consistently with guidance from the Appellate Body and, after weighing all the evidence on the record, concluded that consumer tastes and habits are similar with respect to clove and menthol cigarettes. In Indonesia's view, the United States simply disagrees with the Panel's conclusion.<sup>120</sup> According to Indonesia, when presenting its claims of error, the United States ignored the Appellate Body's view that it is not necessary to show *actual* substitution by consumers when assessing "the extent to which consumers perceive and treat the products as alternative means of performing particular functions in order to satisfy a particular want or demand".<sup>121</sup> Indonesia contends that the United States failed to present evidence showing that consumers, whether adult or youth, would be unwilling to substitute clove and menthol cigarettes for the end-use of smoking. Indonesia argues that the United States is wrong in presuming that consumer tastes and habits must be identical to be like, considering that the Appellate Body found that products that are close to being perfectly substitutable can be like products. Indonesia further submits that there is sufficient evidence on record supporting the fact that young smokers and pre-smoking youth view clove and menthol cigarettes "as *at least* close to substitutable".<sup>122</sup>

<sup>114</sup>Indonesia's appellee's submission, para. 75.

<sup>115</sup>Indonesia's appellee's submission, para. 77.

<sup>116</sup>Indonesia's appellee's submission, para. 78 (referring to Panel Report, para. 7.196).

<sup>117</sup>Indonesia's appellee's submission, para. 76 (referring to Panel Report, para. 7.199).

<sup>118</sup>Indonesia's appellee's submission, para. 78 (referring to United States' response to Panel

Question 41, paras. 104-106).

<sup>119</sup>Indonesia's appellee's submission, para. 79.

<sup>120</sup>Indonesia's appellee's submission, para. 80.

<sup>121</sup>Indonesia's appellee's submission, para. 81 (quoting Appellate Body Report, *EC – Asbestos*,

para. 101), (emphasis added by Indonesia omitted)

<sup>122</sup>Indonesia's appellee's submission, para. 82 (referring to Appellate Body Reports, *Philippines – Distilled Spirits*, para. 149) (original emphasis)

44. Indonesia disagrees with the United States' claim that the Panel erred by failing to include addicted adult smokers in the comparison of consumer tastes and habits. In its view, the Panel's first obligation was to determine the objective of the measure, and then determine which consumers to compare "in light of the context and the object and purpose of the provision at issue" and of the measure.<sup>123</sup> Indonesia recalls that the United States initially agreed with the Panel's focus on the public health aspects of Section 907(a)(1)(A), and only subsequently took issue with the Panel's linkage "of the consideration of likeness under Article 2.1 with the objective of the measure".<sup>124</sup> According to Indonesia, the Panel did not fail to consider Section 907(a)(1)(A) as an integral whole. Rather, in the light of the measure's objective of reducing youth smoking, the Panel concluded that "the perception of consumers, or rather potential consumers, can only be assessed with reference to the health protection objective of the technical regulation at issue".<sup>125</sup>

45. Indonesia further submits that, contrary to what the United States alleges, the Panel did not exclude current consumers from its analysis, since it did include current young smokers. According to Indonesia, what the Panel did was not to include the tastes and habits of adults in its analysis,<sup>126</sup> but to lay out very carefully the basis for its decision to focus on current and pre-smoking youth.<sup>127</sup> Indonesia notes that the Panel established that the purpose of Section 907(a)(1)(A) was to reduce youth smoking, whereas it rejected that a second objective of the measure was to avoid the potential negative consequences or costs associated with banning products to which tens of millions of adults are chemically and psychologically addicted.<sup>128</sup> Accordingly, the Panel evaluated the consumer tastes and habits of youth, following the guidance set out by the Appellate Body to consider the "particular provision in which the term 'like' is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply".<sup>129</sup>

46. Second, Indonesia submits that, in considering evidence regarding consumer tastes and habits, the Panel did not exceed its discretion as the trier of facts, and made an objective assessment of the facts in accordance with Article 11 of the DSU. Indonesia notes, at the outset, that the United States inaccurately cited to the Panel Report when adducing that the Panel focused only on potential young

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<sup>123</sup>Indonesia's appellee's submission, para. 83 (quoting Appellate Body Report, *EC – Asbestos*, paras. 88 and 89). (emphasis added by Indonesia omitted)

<sup>124</sup>Indonesia's appellee's submission, para. 84 (referring to United States' appellant's submission, para. 60).

<sup>125</sup>Indonesia's appellee's submission, para. 86 (quoting Panel Report, para. 7.119).

<sup>126</sup>Indonesia's appellee's submission, para. 87 (referring to United States' appellant's submission, para. 54).

<sup>127</sup>Indonesia's appellee's submission, para. 88 (referring to Panel Report, para. 7.119).

<sup>128</sup>Indonesia's appellee's submission, paras. 90 and 91.

<sup>129</sup>Indonesia's appellee's submission, para. 92 (quoting Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 21, DSR 1996:1, 97, at 114).

smokers.<sup>130</sup> On the contrary, Indonesia posits, the Panel specifically identified the consumers at issue in this case as "young smokers and potential young smokers".<sup>131</sup> In addressing the United States' specific claims, Indonesia argues that the Panel did not willfully disregard or distort evidence. Rather, in Indonesia's view, the Panel carefully reviewed the survey evidence and devoted two paragraphs and five footnotes in its Report to explain that the survey data did not provide clear guidance on comparing consumer tastes and habits, given that the research parameters varied from survey to survey.<sup>132</sup> Indonesia contends that the Panel's approach to the survey evidence hardly amounts to excluding it *a priori* but, rather, that the Panel, acting within its discretion, simply did not place the same importance on the evidence concerning addicted adult smokers as did the United States.<sup>133</sup>

47. Indonesia further submits that the Panel did not make affirmative findings of fact that were not grounded on evidence. In Indonesia's view, while not relying on certain evidence put forward by the United States, the Panel identified and relied on other evidence on the record proving that both clove and menthol cigarettes were "trainer" or "starter" cigarettes that appeal to youth.<sup>134</sup> According to Indonesia, the Panel methodically described a number of sources of evidence (the FDA, the American Lung Association, the WHO, the National Survey on Drug Use and Health, and the Tobacco Products Scientific Advisory Council) indicating that flavoured cigarettes appeal to youth and novice smokers because their characterizing flavours mask the harshness of tobacco. It was based on this evidence that the Panel concluded that all these flavoured cigarettes are perceived as vehicles to start smoking.<sup>135</sup>

48. Lastly, Indonesia adds that the Panel did not commit an egregious error in declining to accord the same weight as the United States sought regarding the addiction rates of use of clove and menthol cigarettes by youth and adults. Referring to Appellate Body reports in *EC – Bed Linen (Article 21.5 – India)*, *Australia – Salmon*, and *Canada – Wheat Exports and Grain Imports*, Indonesia highlights that panels are given "great latitude"<sup>136</sup> in determining what evidence to consider in evaluating the validity of claims and that a panel's decision not to rely on some of the facts submitted by one of the parties would not by itself constitute legal error.<sup>137</sup> In conclusion, Indonesia requests the Appellate

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<sup>130</sup>Indonesia's appellee's submission, para. 100 (referring to United States' appellant's submission, para. 64).

<sup>131</sup>Indonesia's appellee's submission, para. 100 (quoting Panel Report, para. 7.232). (emphasis added by Indonesia)

<sup>132</sup>Indonesia's appellee's submission, para. 104 (referring to Panel Report, paras. 7.209 and 7.210 and footnotes 426-430 thereto).

<sup>133</sup>Indonesia's appellee's submission, para. 106.

<sup>134</sup>Indonesia's appellee's submission, para. 111.

<sup>135</sup>Indonesia's appellee's submission, paras. 112-114.

<sup>136</sup>Indonesia's appellee's submission, para. 116.

<sup>137</sup>Indonesia's appellee's submission, paras. 115-117 (referring to Appellate Body Report, *EC – Bed Linen (Article 21.5 – India)*, para. 177; Appellate Body Report, *Australia – Salmon*, para. 267; and Appellate Body Report, *Canada – Wheat Exports and Grain Imports*, para. 186).

Body to reject the United States' claims with respect to the Panel's findings on consumer tastes and habits, and to uphold the Panel's determination that clove and menthol cigarettes are like products for purposes of Article 2.1 of the *TBT Agreement*.<sup>138</sup>

2. Article 2.1 of the *TBT Agreement* – "Treatment No Less Favourable"

49. Indonesia claims that the Panel did not err in finding that, under Section 907(a)(1)(A) of the FFDCA, imported clove cigarettes are treated less favourably than domestic menthol cigarettes for the purposes of Article 2.1 of the *TBT Agreement*. In particular, Indonesia contends that the Panel did not commit error in identifying the products to be compared for its less favourable treatment analysis, and properly found that the less favourable treatment accorded to clove cigarettes cannot be explained by factors unrelated to their foreign origin. Indonesia further maintains that the Panel did not fail to make an objective assessment of the facts in evaluating the evidence before it, thereby acting consistently with Article 11 of the DSU.

50. First, Indonesia argues that the United States misinterprets the Appellate Body report in *EC – Asbestos* and the panel report in *US – Tuna II (Mexico)* as requiring the Panel to have included treatment of cigarettes with characterizing flavours other than clove and menthol in its less favourable treatment analysis.<sup>139</sup> While the panels in both of the above disputes had conducted an initial like product analysis of a group of products<sup>140</sup>, the scope of the like products to be considered in evaluating less favourable treatment was limited to the imported and domestic products at issue, and did not extend to "other potentially 'like' products in general."<sup>141</sup> Since the products at issue in this dispute had been identified as being imported clove cigarettes and domestically produced menthol cigarettes in the United States, the Panel correctly assessed likeness only as between these two categories of products and, as a consequence, properly identified those products for comparison in its less favourable treatment analysis.<sup>142</sup> Moreover, because neither party argued before the Panel that clove cigarettes were like cigarettes with other characterizing flavours, had the Panel included cigarettes with characterizing flavours other than clove and menthol in its analysis, it would have made a finding on a claim that was not before it, thus acting inconsistently with Article 11 of the DSU.<sup>143</sup>

<sup>138</sup>Indonesia's appellee's submission, para. 118.

<sup>139</sup>Indonesia's appellee's submission, para. 121 (referring to United States' appellant's submission, para. 77).

<sup>140</sup>Indonesia's appellee's submission, para. 126.

<sup>141</sup>Indonesia's appellee's submission, para. 130.

<sup>142</sup>Indonesia's appellee's submission, para. 139 (referring to Panel Report, para. 7.277).

<sup>143</sup>Indonesia's appellee's submission, paras. 140 and 141; see also para. 142 (quoting Appellate Body Report, *Chile – Price Band System*, para. 173).

51. Indonesia further rejects the United States' contention that the Panel incorrectly narrowed the scope of products to be compared on the basis of its terms of reference. Indonesia dismisses this argument as speculative and emphasizes that the Panel referred to its terms of reference in the context of its like products analysis.<sup>144</sup> The Panel never contemplated that flavoured cigarettes other than clove and menthol cigarettes could be included in the like products analysis, which would be consistent with its terms of reference. Moreover, Indonesia's panel request and its subsequent submissions demonstrate that Indonesia raised no claims and made no arguments with respect to cigarettes with characterizing flavours other than clove or menthol.<sup>145</sup> Accordingly, the question of whether the Panel's terms of reference "could have allowed a finding of likeness" between clove cigarettes and other flavoured cigarettes "is moot".<sup>146</sup> Indonesia considers that, "absent a finding of likeness between clove and cigarettes with other characterizing flavors", the Panel could not have included these other flavoured cigarettes in its less favourable treatment analysis.<sup>147</sup>

52. Second, Indonesia argues that the Panel did not exceed its discretion when considering the effect of Section 907(a)(1)(A) on those products that existed at the time the measure went into effect. Indonesia characterizes the United States' argument in this respect as "irrelevant"<sup>148</sup>, and adds that the Panel acted within the limits of its discretion in determining the time period for which a comparison was to be made. While Indonesia agrees that there is "no rigid temporal limitation"<sup>149</sup> on the timeframe for analyzing less favourable treatment, neither is there a mandate to consider any specific timeframe for this analysis.<sup>150</sup> Moreover, Indonesia submits that the United States is arguing that the Panel should have assessed the treatment of the imported product—clove cigarettes—and a domestic product that had not been found to be like—other flavoured cigarettes. However, the "relevant comparison" had to be whether the measure at issue modified the conditions of competition "to the detriment of imported clove cigarettes as compared to menthol cigarettes, which were not banned".<sup>151</sup>

53. Third, Indonesia disagrees with the United States' claim that the Panel acted inconsistently with Article 11 of the DSU by failing to consider evidence demonstrating that cigarettes with characterizing flavours other than clove or menthol were being sold in the United States at the time the measure went into effect. According to Indonesia, because the appropriate products for

<sup>144</sup>Indonesia's appellee's submission, paras. 147 and 148 (referring to United States' appellant's submission, para. 86; and Panel Report, paras. 7.124-7.127).

<sup>145</sup>Indonesia's appellee's submission, paras. 149 and 150 (referring to Indonesia's panel request, pp. 1-2; and Indonesia's responses to Panel Questions 27 and 85).

<sup>146</sup>Indonesia's appellee's submission, para. 150.

<sup>147</sup>Indonesia's appellee's submission, para. 150.

<sup>148</sup>Indonesia's appellee's submission, para. 151.

<sup>149</sup>Indonesia's appellee's submission, para. 152 (quoting United States' appellant's submission, para. 89).

<sup>150</sup>Indonesia's appellee's submission, para. 152; see also para. 154 (quoting Panel Report, *US – Tuna II (Mexico)*, paras. 7.299 and 7.300).

<sup>151</sup>Indonesia's appellee's submission, para. 157.

comparison in the less favourable treatment analysis were clove and menthol cigarettes, the existence of other flavoured cigarettes at the time the ban was imposed is immaterial. Furthermore, Indonesia submits that the Panel did consider and weigh the evidence submitted by the United States regarding the availability of other flavoured cigarettes, but eventually did not find it compelling.<sup>152</sup> Indonesia also points out that evidence on the record showed that the domestically produced brand of clove cigarettes "accounted for a negligible share of all clove cigarettes sold in the United States".<sup>153</sup> In Indonesia's view, the fact that the Panel did not place the same weight on such evidence as did the United States does not amount to a violation of Article 11 of the DSU.

54. Fourth, Indonesia takes issue with the United States' claim that the Panel applied the incorrect legal framework in determining whether the less favourable treatment accorded to clove cigarettes could be explained by factors unrelated to their foreign origin. Indonesia observes that the Appellate Body jurisprudence regarding Article III:4 of the GATT 1994 provides useful guidance in the present dispute<sup>154</sup> and that, under that provision, a less favourable treatment analysis only involves determining whether a measure has the effect of modifying the conditions of competition to the detriment of imported products.<sup>155</sup> According to Indonesia, the United States' claim that no less favourable treatment exists when the detrimental effect on an imported product is not attributable to its foreign origin, but to some other factor, is based on a "mistreading" of the Appellate Body report in *Dominican Republic – Import and Sale of Cigarettes*.<sup>156</sup> On this basis, Indonesia posits, the United States is "attempt[ing] to create a new criterion" when it suggests that a finding of less favourable treatment under Article 2.1 of the *TBT Agreement* would be possible only if a measure's detrimental effects are tied to the foreign origin of the imported product at issue.<sup>157</sup> In fact, no panel or Appellate Body report has ever required under Article III:4 of the GATT 1994 "both a less favourable treatment" test and a second test 'based on national origin'.<sup>158</sup> In other words, Indonesia contends that the Panel's conclusion that imported clove cigarettes are treated less favourably than

<sup>152</sup>Indonesia's appellee's submission, paras. 158 and 162 (referring to Panel Report, footnote 524 to para. 7.289).

<sup>153</sup>Indonesia's appellee's submission, para. 164 (referring to Panel Report, paras. 2.26 and 2.27; and letter dated 25 March 2008 from the President of the Tobacco Merchants Association, Inc. (Panel Exhibit IND-12)).

<sup>154</sup>Indonesia's appellee's submission, para. 169 (referring to Panel Report, para. 7.269, in turn referring to Appellate Body Report, *Korea – Various Measures on Beef*, para. 137; and Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 96).

<sup>155</sup>Indonesia's appellee's submission, para. 172 (referring to Indonesia's opening statement at the first panel meeting, paras. 26 and 58; Indonesia's response to Panel Question 52; and Indonesia's second written submission to the Panel, para. 99).

<sup>156</sup>Indonesia's appellee's submission, para. 173 (referring to Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 96).

<sup>157</sup>Indonesia's appellee's submission, para. 174 (referring to Brazil's oral statement at the Panel meeting with the third parties, para. 11; and Indonesia's second written submission to the Panel, para. 98).

<sup>158</sup>Indonesia's appellee's submission, paras. 179-181 (quoting Appellate Body Report, *Korea – Various Measures on Beef*, para. 135; and Appellate Body Report, *Thailand – Cigarettes (Philippines)*, paras. 128 and 134; and referring to Panel Report, *Mexico – Taxes on Soft Drinks*, paras. 8.114-8.122).

domestic menthol cigarettes—because the former are banned from the US market, whereas the latter are not—is *per se* sufficient to make a finding that the United States acted inconsistently with Article 2.1 of the *TBT Agreement*.<sup>159</sup>

55. In addition, Indonesia disagrees with the United States' claim that the Panel failed to make an objective assessment of the facts as required by Article 11 of the DSU when it found that Section 907(a)(1)(A) did not impose any costs on any US entity without an adequate evidentiary basis. Indonesia contends that there was evidence on the record demonstrating that: (i) the exception for menthol cigarettes under the measure at issue was the result of a political compromise with the US tobacco industry and an effort to protect domestic jobs<sup>160</sup>; and (ii) that the sole reason for excluding menthol cigarettes from the ban was to spare the United States from the costs it might otherwise incur.<sup>161</sup> In evaluating and weighing such evidence, the Panel assessed the facts within the limits of its discretion, and thus did not act inconsistently with Article 11 of the DSU.

### 3. Article 2.12 of the TBT Agreement – "Reasonable Interval"

56. Indonesia submits that the Panel assigned the correct interpretative value to paragraph 5.2 of the Doha Ministerial Decision, and properly found that Indonesia established a *prima facie* case of inconsistency with Article 2.12 of the *TBT Agreement*, which the United States failed to rebut.<sup>162</sup>

57. First, Indonesia contends that the United States incorrectly claims that the Panel declined to formally determine whether paragraph 5.2 of the Doha Ministerial Decision is an "authoritative interpretation" adopted by the Ministerial Conference pursuant to Article IX:2 of the *WTO Agreement*. According to Indonesia, the Panel "clearly concluded" that paragraph 5.2 of the Doha Ministerial Decision is "a binding interpretation".<sup>163</sup> Moreover, Indonesia disagrees with the United States that the Ministerial Conference, in adopting paragraph 5.2, did not act upon the recommendation of the Council for Trade in Goods, as Article IX:2 of the *WTO Agreement* requires. According to Indonesia, the preamble of the Doha Ministerial Decision indicates that the Decision and the interpretations contained therein were adopted on the basis of discussions carried out within the General Council and the WTO subsidiary bodies.

<sup>159</sup>Indonesia's appellee's submission, para. 172.

<sup>160</sup>Indonesia's appellee's submission, para. 187 (referring to Indonesia's second written submission to the Panel, para. 118; S. Saul, "Cigarette Bill Treats Menthol with Leniency", *New York Times*, 13 May 2008 (Panel Exhibit IND-87); and S. Saul, "Bill to Regulate Tobacco Moves Forward", *New York Times*, 3 April 2008 (Panel Exhibit IND-88)).

<sup>161</sup>Indonesia's appellee's submission, para. 189 (referring to Panel Report, para. 7.289, in turn quoting United States' first written submission to the Panel, paras. 23-25; and United States' response to Panel Questions 40, 89, and 109).

<sup>162</sup>Indonesia's appellee's submission, para. 195.

<sup>163</sup>Indonesia's appellee's submission, para. 196 (referring to Panel Report, para. 7.575).

58. In response to the United States' argument that the Doha Ministerial Decision is "at most"<sup>164</sup> a supplementary means of interpretation within the meaning of Article 32 of the *Vienna Convention*, Indonesia submits that the Panel properly determined that paragraph 5.2 of the Doha Ministerial Decision is a "subsequent agreement between the parties" within the meaning of Article 31(3)(a) of the *Vienna Convention*.<sup>165</sup> Moreover, Indonesia argues that the Panel did not err in its interpretation of the term "normally" in paragraph 5.2 of the Doha Ministerial Decision. According to Indonesia, the Panel correctly concluded that the term "normally" must be interpreted as meaning "under normal or usual conditions; as a rule".<sup>166</sup>

59. Second, Indonesia submits that the Panel did not err in finding that Indonesia had established a *prima facie* case of inconsistency with Article 2.12 of the *TBT Agreement*. According to Indonesia, the United States incorrectly argues that the Panel based its finding that Indonesia had established a *prima facie* case "exclusively" on the basis of the text of paragraph 5.2 of the Doha Ministerial Decision.<sup>167</sup> Indonesia contends that the Panel Report clearly shows that the Panel considered both Article 2.12 of the *TBT Agreement* and paragraph 5.2 of the Doha Ministerial Decision.<sup>168</sup> Indonesia contends that this is "categorically stated" by the Panel when it noted that "Indonesia ha[d] persuaded the Panel that, in the light of Article 2.12 of the TBT Agreement and paragraph 5.2 of the Doha Ministerial Decision, an interval of less than six months was not reasonable in the circumstances of this case".<sup>169</sup>

60. In response to the United States' argument that Indonesia provided no evidence or argumentation that the three-month interval period prejudiced the ability of Indonesian producers to adapt to the requirements of Section 907(a)(1)(A) of the FFDCA, Indonesia contends that it adduced sufficient argument and evidence to establish a presumption that the United States had acted inconsistently with its obligation under Article 2.12.<sup>170</sup> According to Indonesia, it did "establish[] a *prima facie* case that the 90-day interval provided by the United States was significantly shorter than the 6 months" normally required.<sup>171</sup> Indonesia submits that, following the elements stipulated in Article 2.12 of the *TBT Agreement*, as well as in the binding interpretation of the term "reasonable interval" in paragraph 5.2 of the Doha Ministerial Decision, Indonesia set forth in its written and oral submissions, as well as in its Panel exhibits, legal arguments and evidence to raise the presumption

<sup>164</sup>Indonesia's appellee's submission, para. 205 (quoting United States' appellant's submission, para. 126).

<sup>165</sup>Indonesia's appellee's submission, para. 206.

<sup>166</sup>Indonesia's appellee's submission, paras. 220 and 221.

<sup>167</sup>Indonesia's appellee's submission, para. 223 (referring to United States' appellant's submission, para. 128).

<sup>168</sup>Indonesia's appellee's submission, para. 227.

<sup>169</sup>Indonesia's appellee's submission, para. 230 (quoting Panel Report, para. 7.594).

<sup>170</sup>Indonesia's appellee's submission, para. 233.

<sup>171</sup>Indonesia's appellee's submission, para. 237.

that its claim against the United States under Article 2.12 was true.<sup>172</sup> Accordingly, Indonesia submits that the Panel did not commit a legal error in finding that Indonesia had established a *prima facie* case of inconsistency with Article 2.12 of the *TBT Agreement*.

61. Third, with regard to the United States' claim that, even assuming that the Panel correctly found that Indonesia had established a *prima facie* case, the Panel committed legal error in finding that the United States had not rebutted Indonesia's *prima facie* case, Indonesia responds that, since it had made out a *prima facie* case, the onus shifted to the United States "to bring forward evidence and arguments to disprove the claim".<sup>173</sup> Since the 90-day interval provided by the United States was significantly shorter than the six months normally required, the burden shifted to the United States to refute the claimed inconsistency. According to Indonesia, the Panel correctly stressed that the United States had failed to explain why it deemed that allowing a longer interval period between the publication and the entry into force of Section 907(a)(1)(A) would not have been effective in fulfilling the objective pursued by the measure, while a three-month interval was.<sup>174</sup> Indonesia also posits that the United States did not explain why six months would have been ineffective, especially taking into account that it did not notify Section 907(a)(1)(A) as an urgent measure pursuant to Article 2.10 of the *TBT Agreement*.<sup>175</sup>

62. According to Indonesia, the Panel weighed and balanced the evidence and arguments on the record and, while it was "convinced of the validity of the claim advanced by Indonesia", it "was not convinced by the rebuttal arguments" presented by the United States.<sup>176</sup> In Indonesia's view, therefore, the Panel acted consistently with its duties since, "in the absence of effective refutation by the defending party, a panel, as a matter of law, is required to rule in favor of the complaining party presenting the *prima facie* case".<sup>177</sup>

### C. Arguments of the Third Participants

#### 1. Brazil

63. Brazil generally agrees with the views expressed by the Panel concerning the legal standard for the assessment of likeness under Article 2.1 of the *TBT Agreement*. For Brazil, the absence of a provision similar to Article III:1 of the GATT 1994, combined with the sixth recital of the preamble

<sup>172</sup>Indonesia's appellee's submission, para. 234.

<sup>173</sup>Indonesia's appellee's submission, para. 240 (quoting Appellate Body Report, *US – Wool Shirts and Blouses*, pp. 16-17, DSR 1997:1, 323, at 338).

<sup>174</sup>Indonesia's appellee's submission, para. 241 (referring to Panel Report, para. 7.593).

<sup>175</sup>Indonesia's appellee's submission, para. 242 (underlining omitted).

<sup>176</sup>Indonesia's appellee's submission, para. 243 (referring to Panel Report, para. 7.591, in turn referring to Appellate Body Report, *EC – Hormones*, para. 104; Appellate Body Report, *Japan – Agricultural Products II*, paras. 98 and 136; and Appellate Body Report, *Japan – Apples*, para. 159).

of the *TBT Agreement*, seems to indicate that the objectives of a technical regulation should play an important role in ascertaining the characteristics of products alleged to be like.<sup>178</sup> Despite there being no direct reference in Article 2.1 of the *TBT Agreement* to the legitimate objectives of the technical regulation, Brazil notes that the use of an overarching analytical concept to inform all paragraphs of a provision is an issue that has already been accepted in WTO jurisprudence.<sup>179</sup> In Brazil's view, the objective pursued by a Member adopting a technical regulation is a central element of the likeness analysis under Article 2.1, given its context and object and purpose.<sup>180</sup> However, Brazil posits, it does not seem reasonable to require a panel to examine the intentions of the regulator and its implications that go beyond the explicit legitimate objective of a measure. The objectives pursued through technical regulations must be assessed as objectively as possible<sup>181</sup>, looking at the measure's structure, architecture, and design.<sup>182</sup> Once the legitimate objectives pursued by a Member are properly revealed, Brazil is of the view that they should inform the likeness analysis under Article 2.1 of the *TBT Agreement*.

64. Brazil further notes that the United States pursues an interpretation of the term "treatment no less favourable" that would require evidence of origin-based detrimental effects to the imported product as a prerequisite for showing *de facto* discrimination.<sup>183</sup> Accordingly, Brazil explains, the United States considers that if any factor, other than the foreign origin of the product, were found to be the basis for the discrimination, there would be no violation of Article 2.1 of the *TBT Agreement*. In Brazil's view, both under Article III:4 of the GATT 1994 and under Article 2.1 of the *TBT Agreement*, a key question is to what extent the application of a measure results in less favourable treatment to the like imported product, regardless of the measure's stated objective.<sup>184</sup> The difference between these two provisions is that, while under Article 2.1 of the *TBT Agreement* the measure's objectives are relevant in defining whether the products at issue are like, under Article III:4 of the GATT 1994, likeness is assessed from a competition perspective.<sup>185</sup> Under both provisions, Brazil contends, once the imported and domestic products are found to be like, the manner in which the measure is applied and the prevailing circumstances of the relevant market for the affected products are more important in a less favourable treatment determination than the measure's

<sup>178</sup>Brazil's third participant's submission, para. 8.

<sup>179</sup>Brazil's third participant's submission, para. 11 (referring to Appellate Body Report, *EC – Asbestos*, para. 98; and Appellate Body Reports, *Philippines – Distilled Spirits*, para. 119).

<sup>180</sup>Brazil's third participant's submission, para. 14.

<sup>181</sup>Brazil's third participant's submission, para. 17.

<sup>182</sup>Brazil's third participant's submission, para. 20 (referring to Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 29; DSR 1996:1, 97, at 120; Appellate Body Report, *Chile – Alcoholic Beverages*, paras. 61 and 62; and Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 112).

<sup>183</sup>Brazil's third participant's submission, para. 23 (referring to United States' appellant's submission, paras. 101-106).

<sup>184</sup>Brazil's third participant's submission, para. 28 (referring to Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 28, DSR 1996:1, 97, at 119).

<sup>185</sup>Brazil's third participant's submission, para. 29.

objectives. According to Brazil, this conclusion is even more relevant in the context of an analysis of a *de facto* discrimination.<sup>186</sup>

## 2. Colombia

65. Colombia submits that the Panel erred in its legal interpretation of paragraph 5.2 of the Doha Ministerial Decision. In its view, the Panel decided to give the Doha Ministerial Decision the status of an authoritative interpretation because it was agreed by all WTO Members meeting in the form of the Ministerial Conference, the highest ranking body of the WTO.<sup>187</sup> According to Colombia, however, this legal conclusion is incorrect. Colombia notes that the Ministerial Conference did not act on the basis of a recommendation by the Council overseeing the functioning of the *TBT Agreement* as mandated by Article IX:2 of the *WTO Agreement*, and, consequently, the first condition of Article IX:2 was not present in this case.<sup>188</sup> Furthermore, the Panel dismissed this condition on the basis that it was only a formal requirement. Colombia considers such reasoning to be in error: first, because the procedural nature of a condition does not mean that it can be overlooked<sup>189</sup>; and, second, because the fact that all Members agreed on a certain interpretation is not sufficient to conclude that such interpretation was adopted pursuant to Article IX:2 of the *WTO Agreement*. With respect to the latter point, Colombia submits that neither the Ministerial Conference nor the General Council have the authority to disregard the previously given consent by all WTO Members embodied in the covered agreements.<sup>190</sup> Colombia further is of the view that the Appellate Body should clarify whether the Doha Ministerial Decision could be considered to constitute, pursuant to Article 31(3)(a) of the *Vienna Convention*, a "subsequent agreement between the parties" on the interpretation of Article 2.12 of the *TBT Agreement*.<sup>191</sup>

## 3. European Union

66. The European Union first submits that the term "like product" appears to be used by the parties and the Panel in two different ways. The first use relates to the "comparison between import and domestic sides" (the "horizontal line")<sup>192</sup>, while the second use concerns the "relationship among the things that are to be considered together" as a product on both the import and domestic sides (the "vertical line").<sup>193</sup> In the European Union's view, the "horizontal line" comparison requires the import and domestic categories to be described in terms that are identical in all respects, otherwise

<sup>186</sup>Brazil's third participant's submission, para. 30.

<sup>187</sup>Colombia's third participant's submission, para. 6 (quoting Panel Report, para. 7.576).

<sup>188</sup>Colombia's third participant's submission, para. 10.

<sup>189</sup>Colombia's third participant's submission, para. 14.

<sup>190</sup>Colombia's third participant's submission, para. 15.

<sup>191</sup>Colombia's third participant's submission, para. 19.

<sup>192</sup>European Union's third participant's submission, para. 17. (original underlining)

<sup>193</sup>European Union's third participant's submission, para. 18. (original underlining)

one cannot meaningfully test for *de facto* discrimination.<sup>194</sup> The "vertical line" comparison, on the other hand, does not require that all things within the set of a "product" be identical in all respects because the comparison is made on the basis of a market definition (that is, by reference to cross-elasticity of supply and demand), hence quite heterogeneous things can be taken together as a single product.<sup>195</sup> The European Union is of the view that, to determine whether there is *de facto* discrimination, it is necessary to consider whether the regulatory distinction is related to the foreign origin of the product.<sup>196</sup> For this reason, the European Union contends that even if clove and menthol cigarettes would be reasonably grouped together as part of a "product", this does not mean that the situation in respect of menthol cigarettes and youth smoking, and clove cigarettes and youth smoking, is necessarily the same or similar.<sup>197</sup>

67. With respect to the less favourable treatment analysis under Article 2.1 of the *TBT Agreement*, the European Union stresses that the relationship between trade and regulation is complex.<sup>198</sup> In its view, the problem is to distinguish between the exercise of regulatory autonomy that is acceptable, and that which is not.<sup>199</sup> This necessarily entails looking at whether the design of the measure is, expressly or by proxy, related to the foreign origin of the regulated products. The European Union also considers that any "countervailing explanations" should be considered together with the inquiry into whether there is some relation with foreign origin, because such an approach provides for the most flexibility when considering a wide range of potential factual situations.<sup>200</sup> In addition, the European Union raises concerns regarding the Panel's approach in allocating the burden of proof under Article 2.1 of the *TBT Agreement*.<sup>201</sup> In particular, according to the European Union, the Panel seems to reason that, because both menthol and clove cigarettes appeal to youth, the only plausible explanation for the failure to extend the ban to menthol cigarettes is *de facto* discrimination.<sup>202</sup> However, this reasoning overlooks the possibility advocated by the United States that the attractiveness of clove cigarettes to youth is more pronounced than in the case of menthol cigarettes.<sup>203</sup> The European Union contends that the Panel did not explain how Indonesia had discharged its burden of proving that the situation with respect to menthol cigarettes and youth smoking was the same as or similar to the situation with respect to clove cigarettes.<sup>204</sup> If Indonesia

<sup>194</sup>European Union's third participant's submission, para. 19.

<sup>195</sup>European Union's third participant's submission, para. 20.

<sup>196</sup>European Union's third participant's submission, para. 21.

<sup>197</sup>European Union's third participant's submission, para. 23.

<sup>198</sup>European Union's third participant's submission, para. 32.

<sup>199</sup>European Union's third participant's submission, para. 33.

<sup>200</sup>European Union's third participant's submission, para. 44.

<sup>201</sup>European Union's third participant's submission, para. 51.

<sup>202</sup>European Union's third participant's submission, para. 54.

<sup>203</sup>European Union's third participant's submission, para. 54 (referring to United States' appellant's submission, paras. 32-36, 54, 55, and 61-63).

<sup>204</sup>European Union's third participant's submission, para. 56.

failed to provide evidence in that respect, the European Union wonders how Indonesia may be considered to have discharged its burden of proof with respect to an alleged "in fact" breach of Article 2.1 of the *TBT Agreement*.<sup>205</sup>

68. Lastly, with respect to Article 2.12 of the *TBT Agreement*, the European Union considers that paragraph 5.2 of the Doha Ministerial Decision is relevant either pursuant to Article 31(3)(a) of the *Vienna Convention*, or as a fact.<sup>206</sup> It further contends that Indonesia had the burden of proving, under Article 2.12 of the *TBT Agreement*, that the time actually allowed by the measure was not reasonable.<sup>207</sup> With respect to the question of whether or not six months would be ineffective in fulfilling the legitimate objective pursued, the European Union finds nothing in the Doha Ministerial Decision that expressly reverses the burden of proof.<sup>208</sup> It recalls, in that regard, that the Appellate Body in *EC – Sardines* placed the burden of proof on the complainant under Article 2.4 of the *TBT Agreement*.<sup>209</sup>

#### 4. Mexico

69. Mexico submits that it is difficult to incorporate the objective of a technical regulation into the like products analysis. In its view, when the purpose of a technical regulation is to protect the highest values, such as human life or health, the analysis of the four criteria will itself be sufficient to reach a correct interpretation of likeness because "the product differences themselves will have inspired the objective of the technical regulation, and not the opposite".<sup>210</sup> Mexico contends, in particular, that the consumer tastes and habits criterion needs to be approached very carefully because regulatory intervention by a Member can "shape consumer perceptions".<sup>211</sup> Moreover, Mexico submits that the creation of sub-categories of like products on the basis of different end-uses, as suggested by the United States, could lead to circumvention of the disciplines in Article 2.1 of the *TBT Agreement*.<sup>212</sup> Mexico further stresses that, if regulatory distinctions could be used to determine like products, this could "render the concept of *de facto* discrimination meaningless".<sup>213</sup>

70. With respect to the Panel's less favourable treatment analysis, Mexico disagrees with the United States that the group of like imported products should include like imported products from all WTO Members and not just from the complaining Member. According to Mexico, the term "any

<sup>205</sup>European Union's third participant's submission, para. 57.

<sup>206</sup>European Union's third participant's submission, para. 62.

<sup>207</sup>European Union's third participant's submission, para. 63.

<sup>208</sup>European Union's third participant's submission, para. 66.

<sup>209</sup>European Union's third participant's submission, para. 67 (referring to Appellate Body Report, *EC – Sardines*, paras. 259-282).

<sup>210</sup>Mexico's third participant's submission, para. 15.

<sup>211</sup>Mexico's third participant's submission, para. 16.

<sup>212</sup>Mexico's third participant's submission, paras. 17-19.

<sup>213</sup>Mexico's third participant's submission, para. 21.

[Member]" under Article 2.1 of the *TBT Agreement* provides "considerable flexibility" when assessing conformity with this provision, and hence the focus can be on like products from "one Member, some Members or all Members".<sup>214</sup> In Mexico's view, the Panel correctly focused on the treatment accorded to like products from Indonesia. In addition, contrary to the United States' argument that the Panel should have compared the treatment accorded to imported and like domestic products as a group, Mexico submits that the Panel's "efficient approach" to applying the "group" comparison when determining less favourable treatment was "not a legal error".<sup>215</sup> On the contrary, the Panel properly found that the "vast majority" of imports of Indonesian cigarettes with characterizing flavours were banned while "all or almost all" of the US cigarettes with characterizing flavours were excluded from the ban.<sup>216</sup>

71. Mexico lastly addresses three additional issues concerning the less favourable treatment analysis. First, it agrees with the Panel's reasoning that a measure is discriminatory when it minimizes the costs for the domestic producers while triggering costs to the foreign producers. In Mexico's view, the Panel's approach is also applicable to any case where the technical regulation is designed in such a way that, either *de facto* or *de jure*, avoids or minimizes costs for the domestic producers and triggers costs to the foreign producers.<sup>217</sup> Second, with respect to the United States' argument that there is no temporal limitation on the analysis of *de facto* less favourable treatment<sup>218</sup>, Mexico posits that the date of a panel's establishment is "the key date" when assessing whether *de facto* discrimination exists.<sup>219</sup> Mexico considers that, although past and possibly future events may inform an assessment of *de facto* discrimination at the time of the establishment of the panel, "great care must be taken when incorporating such facts into the assessment".<sup>220</sup> Third, Mexico is concerned with the interpretation that the non-discrimination obligations in Article 2.1 of the *TBT Agreement* are not violated if the adverse impact is primarily the result of factors "unrelated to the foreign origin of the product".<sup>221</sup> According to Mexico, *de facto* discrimination precisely occurs, by its very nature, when the challenged measure does not, on its face, discriminate on the basis of origin.

<sup>214</sup>Mexico's third participant's submission, para. 40. (original emphasis)

<sup>215</sup>Mexico's third participant's submission, para. 43.

<sup>216</sup>Mexico's third participant's submission, para. 48 (referring to Panel Report, paras. 7.276-7.279).

<sup>217</sup>Mexico's third participant's submission, paras. 53 and 54.

<sup>218</sup>Mexico's third participant's submission, para. 56 (referring to United States' appellant's submission, paras. 91-94).

<sup>219</sup>Mexico's third participant's submission, para. 57.

<sup>220</sup>Mexico's third participant's submission, para. 59.

<sup>221</sup>Mexico's third participant's submission, para. 65 (quoting United States' appellant's submission, para. 101; and referring to Panel Report, para. 7.259, in turn referring to Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 96).

5. Norway

72. Norway agrees with the United States that a panel's terms of reference are not limited by the products listed in a panel request.<sup>222</sup> In this regard, Norway is not convinced by the Panel's reasoning that "the identification of the specific products at issue in a panel request pertains to the claim at issue".<sup>223</sup> In Norway's view, since the product scope of the likeness analysis may influence the outcome of a discrimination claim, a panel should be entitled to define "the product scope of its own analysis" to determine the existence of discrimination, "without being subject to limitations chosen by the complainant, for whatever reason, in its panel request".<sup>224</sup>

73. With respect to the analysis of less favourable treatment, Norway first notes that the Panel compared "one like product (i.e. clove cigarettes), from one source (i.e. Indonesia), to one like domestic product in the United States (i.e. menthol cigarettes)".<sup>225</sup> In its view, however, the Panel should have compared the impact of the measure at issue on "all like imported products, from all WTO Members" vis-à-vis its impact "on all like domestic products".<sup>226</sup> According to Norway, the correct starting point for the analysis should be "the entire group of products identified as like products".<sup>227</sup> Second, Norway disagrees with the United States' assertion that, because its measure distinguishes between cigarettes "on the basis of an origin-neutral criterion *derived from a legitimate regulatory purpose*", it is WTO-consistent.<sup>228</sup> In Norway's view, the United States appears to "stretch the Appellate Body's statement in *Dominican Republic – [Import and Sale of] Cigarettes* too far"<sup>229</sup>, to circumstances that differ from those prevailing in that dispute. A proper assessment of *de facto* discrimination turns on whether the like imported products are predominantly subject to less favourable treatment, while like domestic products are predominantly subject to more favourable treatment. If there is such *de facto* discrimination, whether a measure's policy objective justifies that discrimination belongs more properly to the analysis under an applicable exception.<sup>230</sup>

<sup>222</sup>Norway's third participant's submission, para. 5.

<sup>223</sup>Norway's third participant's submission, para. 6 (quoting Panel Report, para. 7.139).

<sup>224</sup>Norway's third participant's submission, para. 7.

<sup>225</sup>Norway's third participant's submission, para. 12 (referring to Panel Report, paras. 7.274 and 7.275). (original emphasis)

<sup>226</sup>Norway's third participant's submission, para. 12. (original emphasis)

<sup>227</sup>Norway's third participant's submission, para. 13 (referring to Panel Report, *US – Tuna (II) (Mexico)*, para. 7.295, in turn referring to Appellate Body Report, *EC – Asbestos*, para. 100). (original underlining)

<sup>228</sup>Norway's third participant's submission, para. 15. (original emphasis)

<sup>229</sup>Norway's third participant's submission, para. 20 (referring to Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 96).

<sup>230</sup>Norway's third participant's submission, para. 21.

6. Turkey

74. Turkey considers that the Panel did not commit a legal error in its general interpretation of the term "like products" in Article 2.1 of the *TBT Agreement*. In its view, the Panel properly considered the *TBT Agreement* as immediate context while also taking into account the jurisprudence on Article III:4 of the GATT 1994.<sup>231</sup> Turkey thus contends that the Panel correctly found that the declared legitimate public health objective of the measure, namely, reducing youth smoking, "must permeate and inform [its] likeness analysis".<sup>232</sup> Regarding the general assessment of the criteria for determining likeness, Turkey notes that the Appellate Body has rejected a "one-fits-all" approach and has advocated a case-by-case analysis.<sup>233</sup> As for the end-use criterion, Turkey believes that a competition-based approach to determine likeness should not be as influential under the *TBT Agreement* as under Article III of the GATT 1994. Instead, the public health aspect of the measure "creates the immediate context".<sup>234</sup> With respect to consumer tastes and habits, Turkey considers the Panel's focus on the relevant group of consumers—young smokers—not to be erroneous. In its view, it is not necessary to show that consumers are "actually substituting one product for the other"; rather, it is sufficient to show that consumers "can potentially substitute" them.<sup>235</sup>

75. Turkey further submits that the Panel did not commit legal error in limiting its analysis to a comparison between treatment of menthol cigarettes and clove cigarettes under Section 907(a)(1)(A) of the FFDCa. In its view, the Panel was under an obligation to make a comparison between the products specified in its terms of reference because, "at least in this case", the product specification was part of Indonesia's claim itself.<sup>236</sup> In addition, Turkey notes that, in a less favourable treatment analysis, detrimental effects stemming from factors other than the origin of a product are "an essential issue".<sup>237</sup> In assessing this key issue, Turkey contends, the critical benchmark is whether imported and domestic products are treated equally, taking account of all economic and social factors. Turkey therefore considers that the Panel was correct in concluding that the purpose of the *TBT Agreement* would be defeated if Members were "allowed to remove their domestic products" from the application of technical regulations "to avoid potential costs that it might otherwise incur".<sup>238</sup>

<sup>231</sup>Turkey's third participant's submission, para. 4 (referring to Panel Report, para. 7.117).

<sup>232</sup>Turkey's third participant's submission, para. 5 (quoting Panel Report, para. 7.116).

<sup>233</sup>Turkey's third participant's submission, para. 7 (quoting Appellate Body Report, *EC – Asbestos*, para. 101).

<sup>234</sup>Turkey's third participant's submission, para. 11.

<sup>235</sup>Turkey's third participant's submission, para. 15.

<sup>236</sup>Turkey's third participant's submission, paras. 18 and 19.

<sup>237</sup>Turkey's third participant's submission, para. 21.

<sup>238</sup>Turkey's third participant's submission, para. 22 (quoting Panel Report, para. 7.291).

III. **Issues Raised in This Appeal**

76. The following issues are raised in this appeal:

- (a) Whether the Panel erred in finding that Section 907(a)(1)(A) of the FFDCa is inconsistent with Article 2.1 of the *TBT Agreement*, and in particular:
  - (i) Whether the Panel erred in finding that clove cigarettes and menthol cigarettes are like products within the meaning of Article 2.1 of the *TBT Agreement*, and in particular:
    - whether the Panel performed an incomplete analysis of the different end-uses of the products at issue;
    - whether the Panel erred in its analysis of consumer tastes and habits; and
    - whether the Panel acted inconsistently with Article 11 of the DSU in its assessment of consumer tastes and habits;
  - (ii) Whether the Panel erred in finding that Section 907(a)(1)(A) accords to imported clove cigarettes less favourable treatment than that accorded to domestic menthol cigarettes within the meaning of Article 2.1 of the *TBT Agreement*, and in particular:
    - whether the Panel improperly narrowed the product scope of its analysis by comparing treatment accorded to imported clove cigarettes and to domestic menthol cigarettes;
    - whether the Panel erred in assessing less favourable treatment at the time the ban on flavoured cigarettes came into effect;
    - whether the Panel erred in finding that the detrimental impact on competitive opportunities of imported clove cigarettes could not be explained by reasons unrelated to the foreign origin of those products; and
    - whether the Panel acted inconsistently with Article 11 of the DSU in finding that Section 907(a)(1)(A) accords to imported clove

cigarettes less favourable treatment than that accorded to domestic menthol cigarettes; and

(b) Whether the Panel erred in finding that, by failing to allow an interval of not less than six months between the publication and the entry into force of Section 907(a)(1)(A) of the FFDCA, the United States acted inconsistently with Article 2.12 of the *TBT Agreement*, and in particular:

- (i) whether the Panel attributed an incorrect "interpretative value" to paragraph 5.2 of the Doha Ministerial Decision in interpreting the term "reasonable interval" in Article 2.12 of the *TBT Agreement*; and
- (ii) whether the Panel incorrectly found that Indonesia had established a *prima facie* case of inconsistency with Article 2.12 of the *TBT Agreement* that the United States failed to rebut.

#### IV. Background

77. Before commencing our analysis of the issues of law and legal interpretations raised in this appeal, we briefly outline certain pertinent facts and background information. This dispute concerns Section 907(a)(1)(A) of the United States Federal Food, Drug and Cosmetic Act<sup>239</sup> (the "FFDCA"). Section 907(a)(1)(A) was added to the FFDCA by Section 101(b) of the Family Smoking Prevention and Tobacco Control Act<sup>240</sup> (the "FSPTCA")<sup>241</sup>, and became law on 22 June 2009.<sup>242</sup>

78. Under Section 907(a)(1)(A), beginning three months after the enactment of the FSPTCA—that is, as from 22 September 2009:

... a cigarette or any of its components (including the tobacco, filter, or paper) shall not contain, as a constituent ... or additive, an artificial or natural flavour (other than tobacco or menthol) or an herb or spice, including strawberry, grape, orange, clove, cinnamon, pineapple, vanilla, coconut, liquorice, cocoa, chocolate, cherry, or coffee, that is a characterizing flavour of the tobacco product or tobacco smoke.

79. The specific objective of Section 907(a)(1)(A) is not set forth in the FSPTCA itself. However, a report prepared by the House Energy and Commerce Committee<sup>243</sup> (the "House Report")

<sup>239</sup> *Supra*, footnote 2.

<sup>240</sup> *Supra*, footnote 3.

<sup>241</sup> Panel Report, para. 2.4.

<sup>242</sup> Panel Report, para. 2.5 (referring to Indonesia's first written submission to the Panel, footnote 1 to para. 1).

<sup>243</sup> H.R. Rep. No. 111-58, Pt. 1 (2009) (Panel Exhibits IND-2 and US-67).

articulates both the objectives of the FSPTCA overall, and of Section 907(a)(1)(A) in particular. According to the House Report, "[t]he objectives of [the FSPTCA] are to provide the Secretary with the proper authority over tobacco products in order to protect the public health and to reduce the number of individuals under 18 years of age who use tobacco products."<sup>244</sup> The House Report also explains the purpose of Section 907(a)(1)(A) as follows:

Consistent with the overall intent of the bill to protect the public health, including by reducing the number of children and adolescents who smoke cigarettes, Section 907(a)(1)(A) is intended to prohibit the manufacture and sale of cigarettes with certain 'characterizing flavors' that appeal to youth.<sup>245</sup>

80. According to the Guidance for Industry and FDA Staff<sup>246</sup> ("FDA Guidance"), Section 907(a)(1)(A) applies to all flavoured tobacco products<sup>247</sup> that meet the definition of a "cigarette" in Section 3(1) of the Federal Cigarette Labeling and Advertising Act<sup>248</sup>, that is: "(A) any roll of tobacco wrapped in paper or in any substance not containing tobacco"; or "(B) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described [under] (A)."<sup>249</sup> The ban contained in Section 907(a)(1)(A) also extends to flavoured loose tobacco and rolling papers, and filters intended to be used in "roll-your-own" cigarettes.<sup>250</sup>

81. The Panel identified the products at issue in this dispute as being clove cigarettes and menthol cigarettes.<sup>251</sup> Clove cigarettes are composed of tobacco combined with flavouring additives, which is presented to the consumer in a paper wrapped with a filter.<sup>252</sup> More specifically, clove cigarettes are generally manufactured with 60 to 80 per cent tobacco content, usually resulting from a blend of

<sup>244</sup> House Report, p. 14.

<sup>245</sup> House Report, p. 37.

<sup>246</sup> General Questions and Answers on the Ban of Cigarettes that Contain Characterizing Flavors (Edition 2), 23 December 2009 (Panel Exhibit IND-41).

<sup>247</sup> The Panel noted that, in referring to cigarettes *not containing any characterizing flavours*, the parties often used the terms "regular" and "tobacco-flavoured" cigarettes interchangeably, and found this ambiguity to be "susceptible of causing confusion". The Panel observed that referring to tobacco-flavoured cigarettes may confuse the reader into believing that cigarettes such as clove-flavoured or menthol-flavoured cigarettes do not contain tobacco. In fact, *all* cigarettes contain tobacco, but "flavoured" cigarettes such as menthol, kreteks, bidis, and so on, contain, as well, an additive that imparts a characterizing flavour to cigarettes. Therefore, the Panel decided to use the term "regular" cigarettes, and not "tobacco-flavoured" cigarettes, as it better describes the fact that they do not include *additional* characterizing flavours. (Panel Report, para. 7.131)

<sup>248</sup> *United States Code*, Title 15, Chapter 36.

<sup>249</sup> FDA Guidance, answer to Question 2.

<sup>250</sup> FDA Guidance, answers to Questions 3 and 4.

<sup>251</sup> Panel Report, para. 7.147.

<sup>252</sup> Panel Report, para. 7.157 (referring to Indonesia's first written submission to the Panel, para. 54; and Indonesia's second written submission to the Panel, para. 67).

different varieties of tobacco.<sup>253</sup> As for the additives, clove cigarettes contain approximately 20 to 40 per cent cloves, either in the form of clove buds or ground/minced cloves.<sup>254</sup> They also generally include a "sauce" as part of the flavouring ingredients chosen by each manufacturer<sup>255</sup>, as well as other components inherent to cloves, such as benzyl acetate, methyl salicylate, trans-anethole, and methyl eugenol.<sup>256</sup> Before the Panel, the parties did not dispute that clove cigarettes contain eugenol<sup>257</sup>—a substance that the United States defined as "a common topical anesthetic used in dental procedures"<sup>258</sup>—and they also agreed that the Polzin paper, a study on certain ingredients of Indonesian clove cigarettes, shows that 19 of 33 clove cigarette brands analyzed contained coumarin, a flavouring additive.<sup>259</sup>

82. Menthol cigarettes, in contrast, have approximately 90 per cent tobacco content by weight and are composed of a blend of Virginia, Maryland burley, Oriental, and reconstituted tobacco.<sup>260</sup> The Panel noted that the March 2011 report by the Tobacco Products Scientific Advisory Committee to the FDA<sup>261</sup> (the "March 2011 TPSAC Report") specifies that "[m]enthol cigarettes are typically blended using more flue-cured and less burley tobacco ... because some of the chemicals in burley tobaccos create an incompatible taste character with menthol."<sup>262</sup> The main additive in menthol cigarettes is menthol oil, a chemical compound extracted from the peppermint plant (*Mentha piperita*), the corn mint plant (*Mentha arvensis*), or produced by synthetic or semi-synthetic means. Menthol is added to cigarettes in several different ways<sup>263</sup> and diffuses throughout the cigarette, irrespective of the means of application.<sup>264</sup> According to the March 2011 TPSAC Report, menthol is added to cigarettes both as a characterizing flavour and for other taste reasons, which include brightening the flavour of tobacco blends and/or smoothing the taste of the blend. Menthol amounts

<sup>253</sup>Panel Report, para. 7.158 (referring to S. Farrer, "Alternative Cigarettes May Deliver More Nicotine Than Conventional Cigarettes" (August 2003) 18(2) *National Institute on Drug Abuse (NIDA) Notes* (United States' responses to Panel Question 33)).

<sup>254</sup>Panel Report, para. 7.159.

<sup>255</sup>Panel Report, para. 7.160 (referring to United States' first written submission to the Panel, para. 165).

<sup>256</sup>Panel Report, para. 7.164 (referring to Indonesia's response to Panel Question 30).

<sup>257</sup>Panel Report, para. 7.162.

<sup>258</sup>Panel Report, para. 7.161 (quoting United States' first written submission to the Panel, para. 38).

<sup>259</sup>Panel Report, para. 7.163 (referring to Polzin et al., "Determination of eugenol, anethole, and coumarin in the mainstream cigarette smoke of Indonesian clove cigarettes" (October 2007) 45(10) *Food & Chemical Toxicology* (Panel Exhibit US-45)); and Indonesia's and United States' responses to Panel Question 34).

<sup>260</sup>Panel Report, para. 7.166 (referring to United States' response to Panel Question 31). The Panel noted that Indonesia did not provide any specific information in that respect. (*Ibid.*, footnote 357 to para. 7.166)

<sup>261</sup>Available at <http://www.fda.gov/downloads/AdvisoryCommittees/CommitteesMeetingMaterials/TobaccoProductsScientificAdvisoryCommittee/UCM247689.pdf>.

<sup>262</sup>Panel Report, para. 7.166.

<sup>263</sup>The different ways in which menthol is added to cigarettes are the following: (a) by spraying the cut tobacco during blending; (b) by applying it to the pack foil; (c) by injecting it into the tobacco stream; (d) by injecting it into the filter; (e) by inserting a crushable capsule in the filter; (f) by placing a menthol thread in the filter; or (g) any combination of the above. (Panel Report, para. 7.167)

<sup>264</sup>Panel Report, para. 7.167.

to roughly 1 per cent of the content of the cigarette, although the specific amount varies from brand to brand.<sup>265</sup> Moreover, menthol may have cooling, analgesic, or irritating properties, and is reported to reduce sensitivity to noxious chemicals, including nicotine.<sup>266</sup>

83. In this Report, we first consider the United States' claim that the Panel erred in finding that clove and menthol cigarettes are like products within the meaning of Article 2.1 of the *TBT Agreement*. We then address the United States' claim that the Panel erred in finding that the United States acted inconsistently with Article 2.1 of the *TBT Agreement* by according to imported clove cigarettes less favourable treatment than that accorded to domestic menthol cigarettes. Lastly, we consider the United States' claim that the Panel erred in finding that, by not allowing a period of not less than six months between the publication and the entry into force of Section 907(a)(1)(A), the United States acted inconsistently with Article 2.12 of the *TBT Agreement*.

## V. Article 2.1 of the *TBT Agreement*

### A. Introduction

84. The Panel found that Section 907(a)(1)(A) of the FFDCA is a "technical regulation" within the meaning of Annex 1.1 of the *TBT Agreement*, and that it is inconsistent with Article 2.1 of the *TBT Agreement* because it accords to imported clove cigarettes less favourable treatment than that accorded to like menthol cigarettes of national origin.<sup>267</sup> In particular, the Panel found that "clove cigarettes and menthol cigarettes are 'like products' for the purpose of Article 2.1 of the *TBT Agreement*"<sup>268</sup>, and that, "by banning clove cigarettes while exempting menthol cigarettes from the ban, Section 907(a)(1)(A) does accord imported clove cigarettes less favourable treatment than that accorded to domestic menthol cigarettes, for the purpose of Article 2.1 of the *TBT Agreement*".<sup>269</sup>

85. The United States appeals the Panel's finding that Section 907(a)(1)(A) is inconsistent with Article 2.1 of the *TBT Agreement*, and argues that the Panel erred in finding that clove and menthol cigarettes are like products and that Section 907(a)(1)(A) accords to imported clove cigarettes less favourable treatment than that accorded to like products of national origin within the meaning of Article 2.1 of the *TBT Agreement*. We address separately in this Report the United States' claims in respect of the Panel's findings on like products and on less favourable treatment under Article 2.1 of

<sup>265</sup>According to Indonesia, the menthol content can range up to 3 per cent. (Panel Report, para. 7.169 (referring to Indonesia's response to Panel Question 32))

<sup>266</sup>Panel Report, para. 7.168 (referring to March 2011 TPSAC Report, pp. 18-20 and 22).

<sup>267</sup>Panel Report, paras. 7.293, 8.1(a), and 8.1(b).

<sup>268</sup>Panel Report, para. 7.248.

<sup>269</sup>Panel Report, para. 7.292.

the *TBT Agreement*. Before doing so, however, we consider Article 2.1 as a whole in its context and in the light of the object and purpose of the *TBT Agreement*.

86. Article 2.1 of the *TBT Agreement* provides that, with respect to their central government bodies:

Members shall ensure that in respect of technical regulations, products imported from the territory of any Member shall be accorded treatment no less favourable than that accorded to like products of national origin and to like products originating in any other country.

87. Article 2.1 of the *TBT Agreement* contains a national treatment and a most-favoured nation treatment obligation. In this dispute, we are called upon to clarify the meaning of the national treatment obligation. For a violation of the national treatment obligation in Article 2.1 to be established, three elements must be satisfied: (i) the measure at issue must be a technical regulation; (ii) the imported and domestic products at issue must be like products; and (iii) the treatment accorded to imported products must be less favourable than that accorded to like domestic products. The United States' appeal concerns only the second and the third elements of this test of inconsistency, namely, whether the products at issue are like and whether the treatment accorded to clove cigarettes imported from Indonesia is less favourable than that accorded to like domestic products in the United States.<sup>270</sup>

88. In sections V.B and V.C of this Report, we interpret Article 2.1 of *TBT Agreement* and, in particular, the terms "like products" and "treatment no less favourable". However, before engaging in this interpretative effort, we wish to make some observations of general import on: the preamble of the *TBT Agreement*; the definition of "technical regulation"; the relevance of Article III:4 of the GATT 1994 in interpreting Article 2.1 of the *TBT Agreement*; and the absence among the provisions of the *TBT Agreement* of a general exception provision similar to Article XX of the GATT 1994.

89. The preamble of the *TBT Agreement* is part of the context of Article 2.1 and also sheds light on the object and purpose of the Agreement. We find guidance for the interpretation of Article 2.1, in particular, in the second, fifth, and sixth recitals of the preamble of the *TBT Agreement*.

90. The second recital links the *TBT Agreement* to the GATT 1994. It states:

*Desiring* to further the objectives of GATT 1994;

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<sup>270</sup>We recall that it was not disputed before the Panel that Section 907(a)(1)(A) is a technical regulation and that the United States has not appealed the Panel's finding that Section 907(a)(1)(A) is a technical regulation within the meaning of Annex 1.1 to the *TBT Agreement* (Panel Report, paras. 7.21 and 7.41).

91. While this recital may be read as suggesting that the *TBT Agreement* is a "development" or a "step forward" from the disciplines of the GATT 1994<sup>271</sup>, in our view, it also suggests that the two agreements overlap in scope and have similar objectives. If this were not true, the *TBT Agreement* could not serve to "further the objectives" of the GATT 1994. The second recital indicates that the *TBT Agreement* expands on pre-existing GATT disciplines and emphasizes that the two Agreements should be interpreted in a coherent and consistent manner.

92. The fifth recital reflects the trade-liberalization objective of the *TBT Agreement* by expressing the "desire" that technical regulations, technical standards, and conformity assessment procedures do not create unnecessary obstacles to international trade. It states:

*Desiring* however to ensure that technical regulations and standards, including packaging, marking and labelling requirements, and procedures for assessment of conformity with technical regulations and standards do not create unnecessary obstacles to international trade;

93. We see the fifth recital reflected in those TBT provisions that aim at reducing obstacles to international trade and that limit Members' right to regulate, for instance, by prohibiting discrimination against imported products (Article 2.1) or requiring that technical regulations be no more trade restrictive than necessary to fulfil a legitimate objective (Article 2.2).

94. The objective of avoiding the creation of unnecessary obstacles to international trade through technical regulations, standards, and conformity assessment procedures is, however, qualified in the sixth recital by the explicit recognition of Members' right to regulate in order to pursue certain legitimate objectives. The sixth recital states:

*Recognizing* that no country should be prevented from taking measures necessary to ensure the quality of its exports, or for the protection of human, animal or plant life or health, of the environment, or for the prevention of deceptive practices, at the levels it considers appropriate, subject to the requirement that they 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, and are otherwise in accordance with the provisions of this Agreement;

95. We read the sixth recital as counterbalancing the trade-liberalization objective expressed in the fifth recital. The sixth recital "recognizes" Members' right to regulate versus the "desire" to avoid creating unnecessary obstacles to international trade, expressed in the fifth recital. While the fifth recital clearly suggests that Members' right to regulate is not unbounded, the sixth recital affirms

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<sup>271</sup>Panel Report, para. 7.112.

that such a right exists while ensuring that trade-distortive effects of regulation are minimized. The sixth recital suggests that Members' right to regulate should not be constrained if the measures taken are necessary to fulfil certain legitimate policy objectives, and provided that they are not applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade, and are otherwise in accordance with the provisions of the Agreement. We thus understand the sixth recital to suggest that Members have a right to use technical regulations in pursuit of their legitimate objectives, provided that they do so in an even-handed manner and in a manner that is otherwise in accordance with the provisions of the *TBT Agreement*.

96. The balance set out in the preamble of the *TBT Agreement* between, on the one hand, the desire to avoid creating unnecessary obstacles to international trade and, on the other hand, the recognition of Members' right to regulate, is not, in principle, different from the balance set out in the GATT 1994, where obligations such as national treatment in Article III are qualified by the general exceptions provision of Article XX.

97. We observe that Article 2.1 of the *TBT Agreement* applies only in respect of technical regulations, which are defined in Annex 1.1 as "[d]ocument[s] which lay[] down product characteristics or their related processes and production methods, including the applicable administrative provisions, with which compliance is mandatory".<sup>272</sup> Product characteristics laid down in a technical regulation may themselves be relevant to the determination of whether products are like within the meaning of Article 2.1. Thus, we consider that, in the case of technical regulations, the measure itself *may* provide elements that are relevant to the determination of whether products are like and whether less favourable treatment has been accorded to imported products.

98. The definition of technical regulations as documents laying down product characteristics gives an indication that, under the *TBT Agreement*, measures making distinctions based on product characteristics are in principle permitted. However, the fact that a technical regulation defines a product's characteristics with a view to fulfilling a legitimate policy objective does not mean that it may do so by treating imported products less favourably than like domestic products.

99. We note that the language of the national treatment obligation of Article 2.1 of the *TBT Agreement* closely resembles the language of Article III:4 of the GATT 1994. Article III:4 of the GATT 1994 reads, in relevant part:

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<sup>272</sup>The second sentence of Annex 1.1 reads as follows: "It may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method".

The products of the territory of any Member imported into the territory of any other Member 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.

100. The national treatment obligations of Article 2.1 and Article III:4 are built around the same core terms, namely, "like products" and "treatment no less favourable". We further note that technical regulations are in principle subject not only to Article 2.1 of the *TBT Agreement*, but also to the national treatment obligation of Article III:4 of the GATT 1994, as "laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use" of products. The very similar formulation of the provisions, and the overlap in their scope of application in respect of technical regulations, confirm that Article III:4 of the GATT 1994 is relevant context for the interpretation of the national treatment obligation of Article 2.1 of the *TBT Agreement*.<sup>273</sup> We consider that, in interpreting Article 2.1 of the *TBT Agreement*, a panel should focus on the text of Article 2.1, read in the context of the *TBT Agreement*, including its preamble, and also consider other contextual elements, such as Article III:4 of the GATT 1994.<sup>274</sup>

101. Finally, we observe that the *TBT Agreement* does not contain among its provisions a general exceptions clause. This may be contrasted with the GATT 1994, which contains a general exceptions clause in Article XX.

102. With these observations of general import in mind, we turn to the United States' appeal of the Panel's findings that clove and menthol cigarettes are like products, and that Section 907(a)(1)(A) accords imported clove cigarettes from Indonesia less favourable treatment than that accorded to like domestic menthol cigarettes, within the meaning of Article 2.1 of the *TBT Agreement*.

B. *The Panel's Finding that Clove Cigarettes and Menthol Cigarettes are "Like Products" within the Meaning of Article 2.1 of the TBT Agreement*

103. We begin our analysis by addressing the Panel's interpretation of the concept of "like products" under Article 2.1 of the *TBT Agreement*. We then turn to the United States' claims that the

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<sup>273</sup>We recall that, in *EC – Asbestos*, the Appellate Body found that the terms used in one provision "must be interpreted in light of the context, and of the object and purpose, of the provision at issue, and of the object and purpose of the covered agreement in which the provision appears" and that the meaning attributed to the same terms in other provisions of the same agreement or in other covered agreements, may also be relevant context.<sup>274</sup>In setting out its interpretative approach to Article 2.1 of the *TBT Agreement*, the Panel considered that "[e]ven if the GATT 1994 were considered to serve as context for Article 2.1 of the *TBT Agreement*, it would not be the immediate context of that provision" and that "an interpreter should first assess the immediate context of the provision subject to interpretation before reaching for an interpretative aid that is further removed." (Panel Report, para. 7.103)

<sup>274</sup>In setting out its interpretative approach to Article 2.1 of the *TBT Agreement*, the Panel considered that "[e]ven if the GATT 1994 were considered to serve as context for Article 2.1 of the *TBT Agreement*, it would not be the immediate context of that provision" and that "an interpreter should first assess the immediate context of the provision subject to interpretation before reaching for an interpretative aid that is further removed." (Panel Report, para. 7.103)

Panel erred in its interpretation and application of the "likeness" criteria of end-use and consumer tastes and habits, as well as to its claim that the Panel acted inconsistently with Article 11 of the DSU in its assessment of consumer tastes and habits. The United States does not appeal the Panel's findings concerning the products' physical characteristics and tariff classification.

1. "Like Products" under Article 2.1 of the TBT Agreement

104. The Panel found that clove cigarettes and menthol cigarettes are like products within the meaning of Article 2.1 of the *TBT Agreement*.<sup>275</sup> The Panel reached this conclusion after having evaluated the traditional "likeness" criteria (physical characteristics, end-uses, consumer tastes and habits, and tariff classification), "bearing in mind that the measure at issue is a technical regulation, with the immediate purpose of regulating cigarettes having a characterizing flavour, with a view to attaining the legitimate objective of reducing youth smoking".<sup>276</sup> Before addressing the United States' appeal of the Panel's specific findings in respect of the "likeness" criteria of end-uses and consumer tastes and habits, we first consider the Panel's approach to interpreting "like products" in the context of Article 2.1 of the *TBT Agreement*.

105. The Panel considered that "it is far from clear that it is always appropriate to transpose automatically the competition-oriented approach to likeness under Article III:4 of the GATT 1994 to Article 2.1 of the *TBT Agreement*" in the absence of a general principle such as that expressed in Article III:1 of the GATT 1994.<sup>277</sup> The Panel also noted that, despite the similarity in wording, Article 2.1 of the *TBT Agreement* and Article III:4 of the GATT 1994 differ in that the former only applies to technical regulations whereas the latter applies to a much broader range of measures.<sup>278</sup> The Panel stated that Article III:4 of the GATT 1994 could not be regarded as immediate context to Article 2.1 of the *TBT Agreement* and noted that the Appellate Body's reference to an "accordion" of "likeness" allows, and potentially mandates, different interpretations of the term "like products" under Article III:4 of the GATT 1994 and Article 2.1 of the *TBT Agreement*.<sup>279</sup>

106. The Panel turned to what it considered the immediate context of the term "like products" in Article 2.1 of the *TBT Agreement*, namely, Article 2.1 itself and the *TBT Agreement* as a whole, and to that Agreement's object and purpose as set out in its preamble. The Panel considered that the fact that Section 907(a)(1)(A) of the FFDCA is a technical regulation within the meaning of Annex 1.1 of the *TBT Agreement*, which has the immediate purpose of regulating cigarettes with characterizing flavours with the view to attaining the legitimate objective of reducing youth smoking, should have

<sup>275</sup>Panel Report, para. 7.248.

<sup>276</sup>Panel Report, para. 7.244.

<sup>277</sup>Panel Report, para. 7.99.

<sup>278</sup>Panel Report, para. 7.106.

<sup>279</sup>Panel Report, para. 7.105.

"some weight and potentially considerable weight" in the determination of whether the products at issue are like.<sup>280</sup> The Panel also noted that the sixth recital of the preamble of the *TBT Agreement*, which recognizes Members' right to take measures for legitimate objectives, and Article 2.2 could justify a different interpretation of "likeness" under Article 2.1 of the *TBT Agreement* from that developed under Article III:4 of the GATT 1994.<sup>281</sup>

107. The Panel thus found that, in the circumstances of this case, the interpretation of Article 2.1 of the *TBT Agreement* should not be approached primarily from a competition-oriented perspective, but that the weighing of the evidence relating to the "likeness" criteria should be influenced by the fact that Section 907(a)(1)(A) is a technical regulation having the immediate purpose of regulating cigarettes with a characterizing flavour for public health reasons.<sup>282</sup> Having developed this interpretative approach, the Panel turned to the analysis of the traditional "likeness" criteria, namely, the physical characteristics of the products, end-uses, consumer tastes and habits, and tariff classification. The Panel gave particular weight to the health objective of Section 907(a)(1)(A) in its assessment of the products' physical characteristics and of consumer tastes and habits.<sup>283</sup>

108. We agree with the Panel that the interpretation of the term "like products" in Article 2.1 of the *TBT Agreement* should start with the text of that provision in the light of the context provided by Article 2.1 itself, by other provisions of the *TBT Agreement*, and by the *TBT Agreement* as a whole. We also agree that the relevant context includes the fact that Article 2.1 applies to technical regulations, which are documents laying down the characteristics of products. We further note that the preamble of the *TBT Agreement* recognizes Members' right to regulate through technical regulations. As explained below, however, we are not persuaded that these contextual elements and the object and purpose of the *TBT Agreement* suggest that the interpretation of the concept of "like products" in Article 2.1 of the *TBT Agreement* cannot be approached from a competition-oriented perspective.

109. As we have observed above, the balance that the preamble of the *TBT Agreement* strikes between, on the one hand, the pursuit of trade liberalization and, on the other hand, Members' right to regulate, is not, in principle, different from the balance that exists between the national treatment obligation of Article III and the general exceptions provided under Article XX of the GATT 1994. The second recital of the preamble links the two Agreements by expressing the "desire" "to further the objectives of the GATT 1994", while the "recognition" of a Member's right to regulate in the sixth recital is balanced by the "desire" expressed in the fifth recital to ensure that technical

<sup>280</sup>Panel Report, para. 7.109.

<sup>281</sup>Panel Report, para. 7.114.

<sup>282</sup>Panel Report, para. 7.119.

<sup>283</sup>Panel Report, para. 7.119.

regulations, standards, and conformity assessment procedures do not create unnecessary obstacles to international trade. We note, however, that in the GATT 1994 this balance is expressed by the national treatment rule in Article III:4 as qualified by the exceptions in Article XX, while, in the *TBT Agreement*, this balance is to be found in Article 2.1 itself, read in the light of its context and of its object and purpose.

110. The Panel was also of the view that the absence of a provision like Article III:1 of the GATT 1994 in the *TBT Agreement* would prevent the transposition of the GATT competition-oriented approach to likeness to Article 2.1 of the *TBT Agreement*.<sup>284</sup> Article III:1 provides that internal fiscal and regulatory measures "should not be applied to imported or domestic products so as to afford protection to domestic production". We observe, in this respect, that, in *EC – Asbestos*, the Appellate Body considered that the "general principle" articulated in Article III:1 of the GATT 1994 "seeks to prevent Members from applying internal taxes and regulations in a manner which affects the competitive relationship, in the marketplace, between the domestic and imported products involved, 'so as to afford protection to domestic production'".<sup>285</sup> However, the Appellate Body did not base its conclusion that "likeness" in Article III:4 is about the "nature and extent of a competitive relationship between and among products"<sup>286</sup> exclusively on the "general principle" expressed in Article III:1. Rather, the Appellate Body further clarified that "the word 'like' in Article III:4 is to be interpreted to apply to products that are in ... a competitive relationship", because it is "products that are in a competitive relationship in the marketplace [that] could be affected through treatment of imports 'less favourable' than the treatment accorded to domestic products".<sup>287</sup>

111. We agree that the very concept of "treatment no less favourable", which is expressed in the same words in Article III:4 of the GATT 1994 and in Article 2.1 of the *TBT Agreement*, informs the determination of likeness, suggesting that likeness is about the "nature and extent of a competitive relationship between and among products". Indeed, the concept of "treatment no less favourable" links the products to the marketplace, because it is only in the marketplace that it can be determined how the measure treats like imported and domestic products. We note, however, that, in determining likeness based on the competitive relationship between and among the products, a panel should discount any distortive effects that the measure at issue may itself have on the competitive relationship, and reserve the consideration of such effects for the analysis of less favourable treatment. In such cases, a panel should determine the nature and the extent of the competitive relationship for

<sup>284</sup>Panel Report, para. 7.99.

<sup>285</sup>Appellate Body Report, *EC – Asbestos*, para. 98. (original emphasis)

<sup>286</sup>Appellate Body Report, *EC – Asbestos*, para. 99.

<sup>287</sup>Appellate Body Report, *EC – Asbestos*, para. 99. (original emphasis)

the purpose of determining likeness in isolation from the measure at issue, to the extent that the latter informs the physical characteristics of the products and/or consumers' preferences.

112. In the light of the above, we disagree with the Panel that the text and context of the *TBT Agreement* support an interpretation of the concept of "likeness" in Article 2.1 of the *TBT Agreement* that focuses on the legitimate objectives and purposes of the technical regulation, rather than on the competitive relationship between and among the products.

113. We further observe that measures often pursue a multiplicity of objectives, which are not always easily discernible from the text or even from the design, architecture, and structure of the measure. Determining likeness on the basis of the regulatory objectives of the measure, rather than on the products' competitive relationship, would require the identification of all the relevant objectives of a measure, as well as an assessment of which objectives among others are relevant or should prevail in determining whether the products are like. It seems to us that it would not always be possible for a complainant or a panel to identify all the objectives of a measure and/or be in a position to determine which among multiple objectives are relevant to the determination of whether two products are like, or not.<sup>288</sup>

114. The appeal by the United States of the Panel's determination of consumer tastes and habits, which we address further below, highlights the difficulties that arise when attempting to determine likeness based on the regulatory purposes of the measure rather than on the competitive relationship between and among products. The Panel relied on the objective of the measure at issue, which it identified as reducing youth smoking, to determine the likeness of the products.<sup>289</sup> The United States questions the basis for the Panel's narrow focus on the immediate objective of the measure<sup>290</sup> and cites to other regulatory objectives related to health considerations associated with heavily used cigarettes to draw further distinctions between menthol and clove cigarettes.<sup>291</sup>

115. Measures, such as technical regulations, may have more than one objective. However, a panel that is tasked with determining whether two products are like may not be able to reach a coherent result if, in determining likeness, it has to rely on various possible regulatory objectives of the measure. If a panel were to focus on one of the objectives of a measure to the exclusion of all others that are equally important, it may reach a somewhat arbitrary result in the determination of what are the like products at issue which, in turn, has implications for the determination of whether

<sup>288</sup>See Panel Report, *Japan – Alcoholic Beverages II*, para. 6.16.

<sup>289</sup>Panel Report, para. 7.119.

<sup>290</sup>United States' appellant's submission, para. 60.

<sup>291</sup>The United States cites to "possible countervailing public health factors" associated with banning heavily used cigarettes, such as "possible increases in unregulated black market cigarettes or strain to the healthcare system": (United States' appellant's submission, para. 61)

less favourable treatment has been accorded. Moreover, we note that a purpose-based approach to the determination of likeness does not, necessarily, leave more regulatory autonomy for Members, because it almost invariably puts panels into the position of having to determine which of the various objectives purportedly pursued by Members are more important, or which of these objectives should prevail in determining likeness or less favourable treatment in the event of conflicting objectives.

116. More importantly, however, we do not consider that the concept of "like products" in Article 2.1 of the *TBT Agreement* lends itself to distinctions between products that are based on the regulatory objectives of a measure. As we see it, the concept of "like products" serves to define the scope of products that should be compared to establish whether less favourable treatment is being accorded to imported products. If products that are in a sufficiently strong competitive relationship to be considered like are excluded from the group of like products on the basis of a measure's regulatory purposes, such products would not be compared in order to ascertain whether less favourable treatment has been accorded to imported products. This would inevitably distort the less favourable treatment comparison, as it would refer to a "marketplace" that would include some like products, but not others. As we consider further below in respect of the United States' appeal of the Panel's less favourable treatment finding, distinctions among products that have been found to be like are better drawn when considering, subsequently, whether less favourable treatment has been accorded, rather than in determining likeness, because the latter approach would alter the scope and result of the less favourable treatment comparison.

117. Nevertheless, in concluding that the determination of likeness should not be based on the regulatory purposes of technical regulations, we are not suggesting that the regulatory concerns underlying technical regulations may not play a role in the determination of whether or not products are like. In this respect, we recall that, in *EC – Asbestos*, the Appellate Body found that regulatory concerns and considerations may play a role in applying certain of the "likeness" criteria (that is, physical characteristics and consumer preferences) and, thus, in the determination of likeness under Article III:4 of the GATT 1994.

118. In *EC – Asbestos*, the Appellate Body found that, in examining whether products are like, panels must evaluate all relevant evidence, including evidence relating to the health risks associated with a product, which was the underlying concern of the challenged measure in that dispute. The Appellate Body found that such evidence would not be examined as a separate criterion but, rather, under the traditional "likeness" criteria. In particular, the Appellate Body stated that a product's health risks are relevant to the determination of the competitive relationship between products, and addressed health risks as part of the products' physical characteristics and of the tastes and habits of

consumers.<sup>292</sup> In respect of physical characteristics, the Appellate Body considered that a panel should examine fully the physical properties of products, in particular, those physical properties that are likely to influence the competitive relationship between products in the marketplace. These include those physical properties that make a product toxic or otherwise dangerous to health.<sup>293</sup> In respect of consumer tastes and habits, the Appellate Body found that the health risks associated with a product could influence the preference of consumers.<sup>294</sup>

119. Similarly, we consider that the regulatory concerns underlying a measure, such as the health risks associated with a given product, may be relevant to an analysis of the "likeness" criteria under Article III:4 of the GATT 1994, as well as under Article 2.1 of the *TBT Agreement*, to the extent they have an impact on the competitive relationship between and among the products concerned.

120. The interpretation of the concept of "likeness" in Article 2.1 has to be based on the text of that provision as read in the context of the *TBT Agreement* and of Article III:4 of the GATT 1994, which also contains a similarly worded national treatment obligation that applies to laws, regulations, and requirements including technical regulations. In the light of this context and of the object and purpose of the *TBT Agreement*, as expressed in its preamble, we consider that the determination of likeness under Article 2.1 of the *TBT Agreement*, as well as under Article III:4 of the GATT 1994, is a determination about the nature and extent of a competitive relationship between and among the products at issue. To the extent that they are relevant to the examination of certain "likeness" criteria and are reflected in the products' competitive relationship, regulatory concerns underlying technical regulations may play a role in the determination of likeness.

121. With this interpretative approach in mind, we now turn to the claims by the United States that the Panel committed errors in its assessments of the end-uses of clove and menthol cigarettes and of the tastes and habits of consumers of clove and menthol cigarettes, as well as to the United States' claim that the Panel acted inconsistently with Article 11 of the DSU in its assessment of consumer tastes and habits. We begin by examining the Panel's finding that clove and menthol cigarettes have the same end-use.

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<sup>292</sup> Appellate Body Report, *EC – Asbestos*, para. 113.

<sup>293</sup> The Appellate Body noted that a characteristic of chrysotile asbestos fibres was that the microscopic particles and filaments of these fibres were carcinogenic for humans when inhaled. Thus, the Appellate Body concluded that the carcinogenicity, or toxicity, constituted a defining aspect of the physical properties of chrysotile asbestos fibres as opposed to polyvinyl alcohol, cellulose, and glass (PCG) fibres, which did not present the same health risk. (Appellate Body Report, *EC – Asbestos*, para. 114)

<sup>294</sup> The Appellate Body found that the health risks associated with chrysotile asbestos fibres influenced the behaviour of both manufacturers (who incorporate fibres into another product) and ultimate consumers. The Appellate Body noted that a manufacturer cannot ignore the preferences of the ultimate consumers of a product and, if the risks posed by a particular product are sufficiently great, the ultimate consumers may simply cease to buy that product. (Appellate Body Report, *EC – Asbestos*, para. 122)

2. End-Uses

122. In examining the end-uses of clove and menthol cigarettes, the Panel found that both clove and menthol cigarettes have the same end-use, that is, "to be smoked"<sup>295</sup>, and disagreed with the United States that the end-uses of a cigarette include "satisfying an addiction to nicotine" and "creating a pleasurable experience associated with the taste of the cigarette and the aroma of the smoke". The Panel considered that the end-uses presented by the United States relate to the reasons why people smoke, but that does not mean that cigarettes have several end-uses.<sup>296</sup> In particular, the Panel considered that the United States' comments on the appeal of flavours to certain smokers relate more properly to consumer tastes and habits than to end-use.<sup>297</sup>

123. The United States claims that a panel, when conducting an end-use analysis, must consider the different uses of the products and not just the use that is a "common denominator" of the products in question.<sup>298</sup> According to the United States, it is undisputed that both clove and menthol cigarettes are used for smoking, but the Panel improperly limited its analysis to considering only this common use between the products while ignoring other relevant end-uses. Menthol cigarettes, the United States posits, are used to "satisfy the nicotine addictions of millions of smokers in the United States", whereas clove cigarettes are primarily used "for experimentation and special social settings" and generally are not smoked to satisfy nicotine addiction in the US market.<sup>299</sup>

124. Indonesia responds that the Panel did not err in finding that the end-use of clove and menthol cigarettes is "to be smoked". In Indonesia's view, moreover, even assuming *arguendo* that the end-uses put forward by the United States were pertinent ones, the United States presented no evidence showing that clove and menthol cigarettes were not both *capable* of performing the end-uses of satisfying a nicotine addiction and creating a pleasurable experience.<sup>300</sup>

125. We observe that end-uses describe the possible functions of a product, while consumer tastes and habits reflect the consumers' appreciation of these functions. In *EC – Asbestos*, the Appellate Body described end-uses as "the extent to which products are *capable* of performing the same, or similar, functions" and consumer tastes and habits as "the extent to which consumers are willing to

<sup>295</sup> Panel Report, para. 7.199.

<sup>296</sup> Panel Report, para. 7.198.

<sup>297</sup> Panel Report, para. 7.197.

<sup>298</sup> United States' appellant's submission, para. 45.

<sup>299</sup> United States' appellant's submission, para. 46.

<sup>300</sup> Indonesia's appellee's submission, para. 73.

use the products to perform these functions".<sup>301</sup> That a product is not principally used to perform a certain function does not exclude that it may nevertheless be *capable* of performing that function.

126. The Appellate Body has also considered that, while each criterion addresses, in principle, a different aspect of the products involved, which should be examined separately, the different criteria are "interrelated"<sup>302</sup> and "not mutually exclusive", so that certain evidence may well fall under more than one criterion.<sup>303</sup> Thus, in our view, that consumers smoke to satisfy an addiction or that they smoke for pleasure are relevant to the examination of both end-uses and consumer tastes and habits, although different aspects are addressed in the analysis of these two separate "likeness" criteria.

127. We do not consider that it is correct to characterize "satisfying an addiction to nicotine" and "creating a pleasurable experience associated with the taste of the cigarette and the aroma of the smoke" as consumer tastes and habits and not end-uses. To the extent that they describe possible functions of the products, rather than the consumers' appreciation of these functions, they represent, in fact, different end-uses of the products at issue, rather than consumer tastes and habits. Consumer tastes and habits should indicate to what extent consumers are willing to substitute clove cigarettes and menthol cigarettes to "satisfy an addiction to nicotine" and/or to "create a pleasurable experience associated with the taste of the cigarette and the aroma of the smoke".

128. We also recall that, in *EC – Asbestos*, the Appellate Body found that the panel had not provided a complete picture of the various end-uses of the different fibres at issue, because its analysis was based on a "small number of applications" for which the products were substitutable, and because it had failed to examine other, different end-uses for the products. The Appellate Body noted that it is only by forming a complete picture of the various end-uses of a product that a panel can assess the significance of the fact that products share a limited number of end-uses.<sup>304</sup>

129. An analysis of end-use should be comprehensive and specific enough to provide meaningful guidance as to whether the products in question are like products. It is not disputed that both clove and menthol cigarettes are "to be smoked". Nevertheless, "to be smoked" does not exhaustively describe the functions of cigarettes. As a consequence, to find, as the Panel did, that the end-use of both clove and menthol cigarettes is "to be smoked" does not, in our view, provide sufficient guidance as to whether such products are like products within the meaning of Article 2.1 of the *TBT Agreement*.

<sup>301</sup> Appellate Body Report, *EC – Asbestos*, para. 117. (emphasis added)

<sup>302</sup> Appellate Body Report, *EC – Asbestos*, para. 102.

<sup>303</sup> Appellate Body Reports, *Philippines – Distilled Spirits*, para. 131. In that dispute, the Appellate Body considered that factors such as the perceptibility of differences among the products and the products' presentation and labelling concern both physical characteristics and consumer tastes and habits. (*Ibid.*, paras. 128 and 132)

<sup>304</sup> Appellate Body Report, *EC – Asbestos*, para. 119.

Also cigars, loose tobacco, and herbs share the same end-use of being "smoked", although this does not say much as to whether all these products are like.<sup>305</sup>

130. In our view, the Panel did not perform an analysis of the end-uses of clove and menthol cigarettes that was sufficiently comprehensive and specific to provide significant indications as to the likeness of these products. We agree with the United States that there are more specific permutations and functions of "smoking", which are relevant to the end-uses of cigarettes, such as "satisfying an addiction to nicotine" and "creating a pleasurable experience associated with the taste of the cigarette and the aroma of the smoke". The Panel should have considered these permutations and functions in its evaluation of whether the products at issue are like. We also note, however, the argument by Indonesia that, even assuming that the end-uses put forward by the United States were "legitimate end-uses", the United States did not show that clove and menthol cigarettes were not both *capable* of performing the functions of "satisfying an addiction to nicotine" and "creating a pleasurable experience associated with the taste of the cigarette and the aroma of the smoke".<sup>306</sup>

131. The United States argues on appeal that menthol cigarettes are used to satisfy the nicotine addictions of millions of smokers in the United States, while clove cigarettes are primarily used for experimentation and special social settings and generally are not used to satisfy addiction. The Panel, however, found that "both menthol and clove cigarettes appeal to youth because of the presence of an additive that gives them a characterizing flavour having the effect of masking the harshness of tobacco".<sup>307</sup> Both types of cigarettes are capable of performing a social/experimentation function and, thus, share the end-use of "creating a pleasurable experience associated with the taste of the cigarette and the aroma of the smoke". At the same time, both clove and menthol cigarettes are capable of performing the function of "satisfying an addiction to nicotine", considering that both types of cigarettes contain nicotine, whose addictiveness is scientifically proven.<sup>308</sup> The fact that more "addicts" smoke menthol than clove cigarettes does not mean that clove cigarettes cannot be smoked to "satisfy an addiction to nicotine". As we have observed above, what matters in determining a product's end-use is that a product is *capable* of performing it, not that such end-use represents the principal or the most common end-use of that product.

<sup>305</sup>Similarly, to state that the end-use of alcoholic beverages is "to be drunk" would not distinguish alcoholic beverages from water, milk, or orange juice that are also consumed by drinking. In contrast, in *Philippines – Distilled Spirits*, the specific end-use of alcoholic beverages was described as "thirst quenching, socialization, relaxation, pleasant intoxication". (Appellate Body Reports, *Philippines – Distilled Spirits*, para. 171 (quoting Panel Reports, *Philippines – Distilled Spirits*, para. 7.81))

<sup>306</sup>Indonesia's appellee's submission, para. 73.

<sup>307</sup>Panel Report, para. 7.231.

<sup>308</sup>In its response to Panel Question 37, the United States notes that, "[w]ith respect to the addictive effects of regular, menthol and clove cigarettes, all of these products contain nicotine and are thus addictive." (United States' response to Panel Question 37, para. 85)

132. In the light of the above, we disagree with the Panel that the end-use of cigarettes is simply "to be smoked" and agree with the United States that there are more specific end-uses of cigarettes such as "satisfying an addiction to nicotine" and "creating a pleasurable experience associated with the taste of the cigarette and the aroma of the smoke". We consider, however, that, based on the Panel's findings referred to above, it can be concluded that both clove and menthol cigarettes share the end-uses of "satisfying an addiction to nicotine" and "creating a pleasurable experience associated with the taste of the cigarette and the aroma of the smoke". Accordingly, we consider that the more specific products' end-uses put forward by the United States also support the Panel's overall finding that clove and menthol cigarettes are like products.

### 3. Consumer Tastes and Habits

133. In addressing consumer tastes and habits in respect of clove and menthol cigarettes, the Panel stated that the legitimate objective of Section 907(a)(1)(A) of the FFDCA, namely, reducing youth smoking, delimited the scope of the consumers whose tastes and habits should be examined under this criterion.<sup>309</sup> Accordingly, the Panel considered it appropriate to examine the substitutability of clove and menthol cigarettes from the perspective of the relevant group of consumers, which included young smokers and those ready to become smokers (potential consumers).<sup>310</sup> The Panel found that the evidence submitted by the parties showed that both clove and menthol cigarettes, because of their characterizing flavours, which help to mask the harshness of tobacco, appeal to youth and are better vehicles for youth to start smoking than regular cigarettes.<sup>311</sup> Therefore, the Panel concluded that, from the point of view of the consumers at issue in this case, menthol-flavoured and clove-flavoured cigarettes are "similar for the purpose of starting to smoke".<sup>312</sup>

134. The United States claims that the Panel erred in considering the tastes and habits of only young smokers and potential young smokers, and not of current adult smokers. The United States notes that Section 907(a)(1)(A) makes regulatory distinctions among cigarettes based not only on their appeal to young and potential smokers, but also on their use by current adult smokers.<sup>313</sup> The United States argues that nothing in the text of Article 2.1 of the *TBT Agreement* provides a basis for the Panel to have limited its consideration of the public health distinctions drawn under the measure according to what the Panel construed to be the immediate objective of the measure.<sup>314</sup>

<sup>309</sup>Panel Report, para. 7.206.

<sup>310</sup>Panel Report, para. 7.214.

<sup>311</sup>Panel Report, para. 7.217.

<sup>312</sup>Panel Report, para. 7.232.

<sup>313</sup>United States' appellant's submission, para. 54.

<sup>314</sup>United States' appellant's submission, para. 60.

135. The United States contends that a like product analysis under Article 2.1 must take account of the regulatory distinctions drawn under the measure at issue, which are not limited to the immediate or primary objective of a measure, but that often reflect a balancing of other considerations relevant to the public welfare. In particular, the United States argues that, even though the primary or immediate purpose of Section 907(a)(1)(A) is to reduce youth smoking, the measure was developed based on a consideration of the health benefits, risks, and consequences to the population as a whole, including the possible negative consequences of banning a type of cigarette, such as menthol cigarettes, to which millions of adults are chemically and psychologically addicted.<sup>315</sup>

136. We have disagreed with the Panel's approach to interpreting the concept of "likeness" in Article 2.1 of the *TBT Agreement* in the light of the regulatory objectives of the measure, rather than based on the competitive relationship between and among the products.<sup>316</sup> In particular, we have observed that the context of the *TBT Agreement* and its object and purpose do not suggest that the regulatory objectives of a technical regulation should play a role that is separate from the determination of a competitive relationship between and among products. We have also noted that determining likeness primarily in the light of the regulatory objectives of the measure is further complicated by the fact that measures, including technical regulations, often have multiple objectives. In contrast, we have considered that the determination of likeness under Article 2.1 of the *TBT Agreement* is a determination about the nature and the extent of a competitive relationship between and among products, and that the regulatory concerns that underlie a measure may be considered to the extent that they have an impact on the competitive relationship.<sup>317</sup>

137. In the light of the above, we also consider that the Panel was wrong in confining its analysis of consumer tastes and habits to those consumers (young and potential young smokers) that are the concern of the objective of the regulation (to reduce youth smoking). In an analysis of likeness based on products' competitive relationship, it is the market that defines the scope of consumers whose preferences are relevant. The proportion of youth and adults smoking different types of cigarettes may vary, but clove, menthol, and regular cigarettes are smoked by both young and adult smokers. To evaluate the degree of substitutability among these products, the Panel should have assessed the tastes and habits of all relevant consumers of the products at issue, not only of the main consumers of clove and menthol cigarettes, particularly where it is clear that an important proportion of menthol cigarette smokers are adult consumers.

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<sup>315</sup>United States' appellant's submission, para. 62. The United States cites in particular to "possible increases in unregulated black market cigarettes or strain to the healthcare system". (United States' appellant's submission, para. 61)

<sup>316</sup>Section V.B.1 of this Report.

<sup>317</sup>See *supra*, para. 119.

138. Moreover, without at this stage entering into the merits of the other objectives of the regulation advocated by the United States, the Panel's approach discounts the fact that the technical regulation at issue may also have other objectives that concern other actual and potential consumers of the products at issue. Therefore, we disagree with the Panel that the legitimate objective of Section 907(a)(1)(A), that is, reducing youth smoking, delimits the scope of the consumers whose tastes and habits should be examined to young smokers and potential young smokers.<sup>318</sup>

139. Having determined that the Panel was wrong in confining its analysis of consumer tastes and habits to young and potential young smokers, we now consider whether the Panel's failure to evaluate the tastes and habits of current adult consumers of menthol cigarettes undermines the proposition that there is a sufficient degree of substitutability between clove and menthol cigarettes to support an overall finding of likeness under Article 2.1 of the *TBT Agreement*.

140. The United States claims that "[e]vidence comparing the tastes and habits of younger, potential smokers and the tastes and habits of older, established smokers is directly relevant to the issue of consumer tastes and habits", because clove cigarettes are smoked disproportionately by youth, while menthol cigarettes are smoked more evenly among young and adult smokers. Accordingly, the United States argues, clove cigarettes present a unique risk to young, uninitiated smokers and have little to no impact on adults, while menthol cigarettes are a risk to young, uninitiated smokers, but also have a significant impact on adults.<sup>319</sup>

141. Indonesia submits that the United States failed to present evidence showing that consumers, whether adult or youth, would be unwilling to substitute clove and menthol cigarettes for the end-use of smoking. Indonesia argues that the United States is wrong in presuming that consumer tastes and habits must be identical to be like, considering that the Appellate Body found that products that are close to being perfectly substitutable can be like products. Indonesia contends that there is sufficient evidence on record supporting the fact that young smokers and pre-smoking youth view clove and menthol cigarettes "as at least close to substitutable".<sup>320</sup>

142. We consider that, in order to determine whether products are like under Article 2.1 of the *TBT Agreement*, it is not necessary to demonstrate that the products are substitutable for all consumers or that they actually compete in the entire market. Rather, if the products are highly substitutable for some consumers but not for others, this may also support a finding that the products are like. In *Philippines – Distilled Spirits*, the Appellate Body considered that the standard of "directly

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<sup>318</sup>Panel Report, paras. 7.206.

<sup>319</sup>United States' appellant's submission, para. 55.

<sup>320</sup>Indonesia's appellee's submission, para. 82 (referring to Appellate Body Reports, *Philippines – Distilled Spirits*, para. 149).

competitive or substitutable" relating to Article III:2, second sentence, of the GATT 1994 is satisfied even if competition does not take place in the whole market but is limited to a segment of the market. The Appellate Body found that "it was reasonable for the [panel] to draw, from the Philippines' argument that imported distilled spirits are only available to a 'narrow segment' of its population, the inference that there is actual competition between imported and domestic distilled spirits at least in the segment of the market that the Philippines admitted has access to both imported and domestic distilled spirits".<sup>321</sup> In that same dispute, the Appellate Body found that Article III:2, second sentence, does not require that competition be assessed in relation to the market segment that is most representative of the "market as a whole", and that Article III of the GATT 1994 "does not protect just *some* instances or *most* instances, but rather, it protects *all* instances of direct competition".<sup>322</sup>

143. Although the Appellate Body's finding in *Philippines – Distilled Spirits* concerned the second sentence of Article III:2 of the GATT 1994, we consider this interpretation of "directly competitive or substitutable products" to be relevant to the concept of "likeness" in Article III:4 of the GATT 1994 and 2.1 of the *TBT Agreement*, since likeness under these provisions is determined on the basis of the competitive relationship between and among the products.<sup>323</sup> In our view, the notion that actual competition does not need to take place in the whole market, but may be limited to a segment of the market, is separate from the question of the degree of competition that is required to satisfy the standards of "directly competitive or substitutable products" and "like products".

144. The Panel's consideration of consumer tastes and habits was too limited. At the same time, the mere fact that clove cigarettes are smoked disproportionately by youth, while menthol cigarettes are smoked more evenly by young and adult smokers does not necessarily affect the degree of substitutability between clove and menthol cigarettes. The Panel found that, from the perspective of young and potential young smokers, clove-flavoured cigarettes and menthol-flavoured cigarettes are similar for purposes of starting to smoke.<sup>324</sup> We understand this as a finding that young and potential young smokers perceive clove and menthol cigarettes as sufficiently substitutable. This, in turn, is sufficient to support the Panel's finding that those products are like within the meaning of Article 2.1 of the *TBT Agreement*, even if the degree of substitutability is not the same for all adult smokers.

<sup>321</sup> Appellate Body Reports, *Philippines – Distilled Spirits*, para. 220.

<sup>322</sup> Appellate Body Reports, *Philippines – Distilled Spirits*, para. 221 (referring to Panel Report, *Chile – Alcoholic Beverages*, para. 7.43). (original emphasis)

<sup>323</sup> In *EC – Asbestos*, the Appellate Body, while not defining the precise scope of the concept of "like products" in Article III:4, found that Article III:4 applies to products that are in a competitive relationship and that "the scope of 'like' in Article III:4 is broader than the scope of 'like' in Article III:2, first sentence". (Appellate Body Report, *EC – Asbestos*, para. 99)

<sup>324</sup> Panel Report, para. 7.232.

145. In the light of the above, we are of the view that, while the Panel should not have limited its analysis of consumer tastes and habits to young and potential young smokers to the exclusion of current adult smokers, this does not undermine the Panel's finding regarding consumer tastes and habits and its ultimate finding of likeness. This is so because the degree of competition and substitutability that the Panel found for young and potential young smokers is sufficiently high to support a finding of likeness under Article 2.1 of the *TBT Agreement*.

146. Finally, we turn to the claim by the United States that the Panel acted inconsistently with Article 11 of the DSU when it reached the conclusion that clove cigarettes and menthol cigarettes are perceived similarly by the consumers at issue in this case, and that it disregarded critical evidence on how consumers actually use and perceive the products at issue in the relevant market.<sup>325</sup>

147. The United States emphasizes that clove cigarettes are smoked disproportionately by young, novice smokers while menthol cigarettes are smoked more evenly by young people and adults. It recalls that both parties presented evidence—in particular a set of surveys—aimed at shedding light on the tastes and habits of consumers in the United States in respect of clove and menthol cigarettes. However, the United States argues, the Panel disregarded this evidence after having erroneously concluded that it could not "rely on the information provide[d]" in the surveys on the basis that this information was "not directly comparable".<sup>326</sup> The United States submits that the survey data before the Panel were "directly relevant to the question" before it because the data provided evidence on how consumers and potential consumers "used and perceived different cigarettes in the United States"<sup>327</sup>, that is, the relevant market. The United States further argues that, after disregarding this evidence, the Panel proceeded to base its conclusions "entirely on speculation and conjecture", without any evidentiary support as to how consumers in the relevant market actually use the cigarettes at issue.<sup>328</sup>

148. Indonesia responds that, given that the research parameters varied from survey to survey, the Panel properly concluded that the survey data did not provide clear guidance on "consumer tastes and habits". In its view, the Panel's approach to that evidence "hardly amounts to excluding it *a priori*".<sup>329</sup> Instead, the Panel "clearly articulated the difficulties it encountered in comparing the survey data and simply did not place the same weight on the evidence as did the United States. Indonesia further argues that the Panel identified and relied on evidence showing that both clove and menthol cigarettes

<sup>325</sup> United States' appellant's submission, para. 64.

<sup>326</sup> United States' appellant's submission, para. 66 (quoting Panel Report, para. 7.210).

<sup>327</sup> United States' appellant's submission, para. 67. (original emphasis)

<sup>328</sup> United States' appellant's submission, para. 68.

<sup>329</sup> Indonesia's appellee's submission, para. 106.

<sup>330</sup> Indonesia's appellee's submission, para. 115.

are "trainer" or "starter" cigarettes that appeal to youth.<sup>331</sup> Based on this evidence on record, the Panel properly found that "all these flavoured cigarettes are perceived as vehicles to start smoking".<sup>332</sup>

149. We observe that Article 11 of the DSU requires a panel to make an objective assessment of the matter before it, including an objective assessment of the facts of the case. Thus, Article 11 requires a panel to "consider all the evidence presented to it, assess its credibility, determine its weight, and ensure that its factual findings have a proper basis in that evidence."<sup>333</sup> In addition, panels "are not required to accord to factual evidence of the parties the same meaning and weight as do the parties."<sup>334</sup> In this respect, the Appellate Body will not "interfere lightly" with a panel's fact-finding authority, and will not "base a finding of inconsistency under Article 11 simply on the conclusion that [it] might have reached a different factual finding".<sup>335</sup> Instead, for a claim under Article 11 to succeed, the Appellate Body must be satisfied that the panel has exceeded its authority as the initial trier of facts. As the initial trier of facts, a panel must provide "reasoned and adequate explanations and coherent reasoning"<sup>336</sup>, must base its finding on a sufficient evidentiary basis<sup>337</sup>, and must treat evidence with "even-handedness".<sup>338</sup> Moreover, a participant claiming that a panel disregarded certain evidence must explain why the evidence is so material to its case that the panel's failure to address such evidence has a bearing on the objectivity of the panel's factual assessment.<sup>339</sup>

150. Both the United States and Indonesia relied on a series of surveys addressing smoking patterns in the United States in order to support their respective arguments.<sup>340</sup> The Panel observed,

<sup>331</sup>Indonesia's appellee's submission, para. 111.

<sup>332</sup>Indonesia's appellee's submission, para. 113 (quoting Panel Report, para. 7.231).

<sup>333</sup>Appellate Body Reports, *Philippines – Distilled Spirits*, para. 135 (quoting Appellate Body Report, *Brazil – Retreaded Tyres*, para. 185, in turn referring to Appellate Body Report, *EC – Hormones*, paras. 132 and 133).

<sup>334</sup>Appellate Body Report, *Australia – Salmon*, para. 267.

<sup>335</sup>Appellate Body Reports, *Philippines – Distilled Spirits*, para. 136 (quoting Appellate Body Report, *US – Wheat Gluten*, para. 151).

<sup>336</sup>Appellate Body Report, *US – Upland Cotton (Article 21.5 – Brazil)*, footnote 618 to para. 293.

<sup>337</sup>See Appellate Body Report, *US – Carbon Steel*, para. 148.

<sup>338</sup>Appellate Body Report, *US – Upland Cotton (Article 21.5 – Brazil)*, para. 292.

<sup>339</sup>See Appellate Body Report, *EC – Fasteners (China)*, para. 442.

<sup>340</sup>Indonesia relied on the following four surveys: (i) the 2006-2008 National Survey on Drug Use and Health; (ii) the 2009 Western Watts Survey; (iii) the 2009 Monitoring the Future Survey; and (iv) a 2010 telephone survey conducted by Opinion Research Corporation. (Panel Report, footnote 426 to para. 7.210 (referring to National Survey on Drug Use and Health 2006-2008, "Essential Facts About Clove Cigarettes" (Panel Exhibit IND-3); Western Watts Data Collection, "Clove Cigarettes Attitude, Awareness and Usage Survey", 16-19 February 2009 (Panel Exhibit IND-26); L.D. Johnston et al., "Smoking continues gradual decline among U.S. teens, smokeless tobacco threatens a comeback," *University of Michigan News Service*, 14 December 2009 (Panel Exhibit IND-33); and Opinion Research Corporation, Teen CARAVAN Study No. 719381, 23-26 September 2010 (Panel Exhibit IND-34)) The United States based its arguments on two surveys: (i) the 2002-2003 National Survey on Drug Use and Health; and (ii) the National Youth Tobacco Survey. (Panel Report, footnote 426 to para. 7.210 (referring to FDA Survey Assessment, "Patterns of Use Among Menthol, Clove, and Other Flavored Cigarettes (Panel Exhibit US-53))

however, that these surveys "do not share the same research parameters"<sup>341</sup>; instead, they "examine[d] different age groups", "pose[d] different questions", and were "based on different methodological approaches".<sup>342</sup> Consequently, in the Panel's view, the information contained in the different surveys was "not directly comparable". On this basis, the Panel reached the conclusion that it could not "rely on the information [that the surveys] provide on market shares for the purposes of analyzing the consumers' tastes and habits criterion"<sup>343</sup>, and that "the evidence on consumer preferences submitted by the parties may not provide clear guidance" as to whether clove and menthol cigarettes are substitutable from the perspective of young smokers and potential young smokers.<sup>344</sup>

151. We acknowledge that extracting meaningful information from surveys that differ considerably in terms of research parameters might not be an easy task. Likewise, we do not suggest that panels must always be capable of engaging in sophisticated statistical exercises to solve data discrepancies that ultimately cannot be resolved. However, the fact that evidence relied on by the parties may be difficult to compare cannot excuse the panel from examining it. A panel has the obligation to "consider *all* the evidence presented to it"<sup>345</sup>, and it should at least attempt to extract potentially relevant information contained therein. It is only after such an examination that a panel might be able to provide "reasoned and adequate explanations"<sup>346</sup> as to why it cannot or chooses not to rely on specific evidence submitted by the parties. In our view, a panel cannot determine *a priori* that some pieces of evidence are not reliable for the purposes of its analysis solely on the basis of a difference in the parameters and methodology used.

152. We recall, however, that not every error allegedly committed by a panel amounts to a violation of Article 11 of the DSU. A participant claiming that a panel ignored certain evidence must explain why that evidence is so material to its case that the panel's failure to address such evidence has a bearing on the objectivity of the panel's factual assessment.<sup>347</sup> In that respect, the United States submits that, because the Panel did not examine the evidence related to consumers' tastes and habits, the Panel's finding with respect to this criterion "was fatally flawed".<sup>348</sup> In the United States' view, the survey data presented by the parties "show that consumers and potential consumers use and

<sup>341</sup>Panel Report, para. 7.210.

<sup>342</sup>Panel Report, para. 7.210.

<sup>343</sup>Panel Report, para. 7.210.

<sup>344</sup>Panel Report, para. 7.210.

<sup>345</sup>Appellate Body Reports, *Philippines – Distilled Spirits*, para. 135 (quoting Appellate Body Report, *Brazil – Retreaded Tyres*, para. 185, in turn referring to Appellate Body Report, *EC – Hormones*, paras. 132 and 133).

<sup>346</sup>Appellate Body Report, *US – Upland Cotton (Article 21.5 – Brazil)*, footnote 618 to para. 293.

<sup>347</sup>Appellate Body Report, *EC – Fasteners (China)*, para. 442.

<sup>348</sup>United States' appellant's submission, para. 68.

perceive clove and menthol cigarettes differently—even though they are both cigarettes with characterizing flavors that appeal to youth".<sup>349</sup>

153. We have considered above, in respect of the claim by the United States that the Panel erred in the application of the consumer tastes and habits criterion, that, although the Panel should not have limited its analysis to young and potential young consumers, to the exclusion of current adult consumers, this did not affect its finding that there is sufficient substitutability between clove and menthol cigarettes to support its overall finding that the products are like. The Panel's findings show that, while clove and menthol cigarettes do not compete in the whole market, these products are substitutable for young and potential young consumers.

154. Therefore, in our view, the fact that the Panel did not rely on evidence demonstrating that clove cigarettes are disproportionately smoked by youth while menthol cigarettes are smoked by both youth and adults, does not have material consequences for the Panel's finding on consumer tastes and habits. This is so because the Panel found that there is a sufficient degree of substitutability, at least in some segments of the market, between clove and menthol cigarettes, to support a finding of likeness under Article 2.1 of the *TBT Agreement*.

155. In sum, we are not persuaded that the reasons advanced by the Panel for not relying on the surveys submitted by the parties justify the cursory treatment given by the Panel to these surveys. Even if this evidence was not directly comparable or based on different methodological approaches, the Panel was required to consider this evidence and extract relevant information that it contained. The Panel did not provide an adequate explanation as to why this was not possible. Nevertheless, in our view, the Panel's error does not amount to a violation of Article 11 of the DSU, considering that the evidence that the Panel did not engage with does not have material consequences for the Panel's finding that consumer tastes and habits indicate that clove and menthol cigarettes are sufficiently substitutable in certain segments of the market, and does not, therefore, undermine the Panel's finding that clove and menthol cigarettes are like products under Article 2.1 of the *TBT Agreement*.

#### 4. Conclusion on "Like Products"

156. We have disagreed with the Panel's interpretation of the concept of "like products" in Article 2.1 of the *TBT Agreement*, which focuses on the purposes of the technical regulation at issue, as separate from the competitive relationship between and among the products. In contrast, we have concluded that the context provided by Article 2.1 itself, by other provisions of the *TBT Agreement*, by the *TBT Agreement* as a whole, and by Article III:4 of the GATT 1994, as well as the object and

purpose of the *TBT Agreement*, support an interpretation of the concept of "likeness" in Article 2.1 that is based on the competitive relationship between and among the products and that takes into account the regulatory concerns underlying a technical regulation, to the extent that they are relevant to the examination of certain likeness criteria and are reflected in the products' competitive relationship.

157. As a consequence of our interpretative approach to the concept of "like products" in Article 2.1 of the *TBT Agreement*, we have also disagreed with the Panel's decision to examine the extent of substitutability of clove and menthol cigarettes from the perspective of a limited group of consumers, that is, young smokers and potential young smokers. We have, nevertheless, considered that the Panel's error does not vitiate the conclusion that there is a sufficient degree of substitutability between clove and menthol cigarettes to support an overall finding of likeness under Article 2.1 of the *TBT Agreement*. We have also determined that the Panel's decision that it could not rely on certain evidence submitted by the parties did not amount to an error under Article 11 of the DSU.

158. In respect of end-use, we have disagreed with the Panel's conclusion that the end-use of clove and menthol cigarettes is simply "to be smoked". Nevertheless, we have considered, based on the Panel's findings, that both clove and menthol cigarettes are *capable* of performing the more specific end-uses put forward by the United States, that is, "satisfying an addiction to nicotine" and "creating a pleasurable experience associated with the taste of the cigarette and the aroma of the smoke".<sup>350</sup> We have thus concluded that the different end-uses of clove and menthol cigarettes support the Panel's overall finding of likeness.

159. Finally, we observe that the United States has not appealed the Panel's findings regarding the physical characteristics and the tariff classification of clove and menthol cigarettes. The Panel found that clove and menthol cigarettes are physically similar as "they share their main traits as cigarettes, that is, having tobacco as a main ingredient, and an additive which imparts a characterizing flavour, taste and aroma, and reduces the harshness of tobacco"<sup>351</sup>; and that they are both classified under subheading 2402.20 of the Harmonized Commodity Description and Coding System.<sup>352</sup>

160. In the light of all of the above, while we disagree with certain aspects of the Panel's analysis, we agree with the Panel that the "likeness" criteria it examined support its overall conclusion that clove and menthol cigarettes are like products within the meaning of Article 2.1 of the *TBT Agreement*. Therefore, we *uphold*, albeit for different reasons, the Panel's finding, in

<sup>350</sup>Panel Report, para. 7.231; United States' response to Panel Question 37, para. 85.

<sup>351</sup>Panel Report, para. 7.187.

<sup>352</sup>Panel Report, para. 7.239.

<sup>349</sup>United States' appellant's submission, para. 69.

paragraph 7.248 of the Panel Report, that clove cigarettes and menthol cigarettes are like products within the meaning of Article 2.1 of the *TBT Agreement*.

C. *The Panel's Finding that Section 907(a)(1)(A) of the FFDCA Accords Imported Clove Cigarettes Less Favourable Treatment than That Accorded to Domestic Menthol Cigarettes, within the Meaning of Article 2.1 of the TBT Agreement*

1. Introduction

161. In this section, we address the United States' appeal of the Panel's finding that the United States acted inconsistently with Article 2.1 of the *TBT Agreement* by according to clove cigarettes imported from Indonesia less favourable treatment than that accorded to domestic like products.

162. Having concluded that clove and menthol cigarettes are like products within the meaning of Article 2.1 of the *TBT Agreement*, the Panel undertook a four-step analysis to determine whether Section 907(a)(1)(A) of the FFDCA accords to clove cigarettes imported from Indonesia less favourable treatment than that accorded to like domestic products. First, the Panel sought to determine the products to be compared in its analysis.<sup>353</sup> The Panel found that Article 2.1 called for a comparison between treatment accorded to, on the one hand, clove cigarettes imported from Indonesia, and, on the other hand, domestic menthol cigarettes.<sup>354</sup> Second, the Panel determined that under Section 907(a)(1)(A) clove and menthol cigarettes are treated differently, in that clove cigarettes are banned while menthol cigarettes are excluded from the ban.<sup>355</sup> Third, the Panel found that such difference in treatment modifies the conditions of competition to the detriment of the imported products, insofar as imported clove cigarettes are banned while domestic menthol cigarettes are allowed to remain in the market.<sup>356</sup> Fourth and finally, the Panel rejected the United States' argument that such detrimental impact could be "explained by factors or circumstances unrelated to the foreign origin of the products"<sup>357</sup>, because Section 907(a)(1)(A) imposes costs on foreign producers, notably producers in Indonesia, while at the same time imposing no costs on any US entity.<sup>358</sup>

163. On appeal, the United States claims that the Panel improperly narrowed the *product scope* of its analysis by focusing exclusively on treatment accorded to imported clove cigarettes and to

<sup>353</sup>Panel Report, para. 7.270.

<sup>354</sup>Panel Report, paras. 7.275-7.277.

<sup>355</sup>Panel Report, paras. 7.279 and 7.280.

<sup>356</sup>Panel Report, para. 7.281.

<sup>357</sup>Panel Report, para. 7.283 (referring to United States' second written submission to the Panel, para. 127, in turn referring to Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 96).

<sup>358</sup>Panel Report, para. 7.289.

domestic menthol cigarettes. The United States posits that the Panel should have compared the treatment accorded to the group of imported and to the group of domestic like products. The United States also claims that the Panel improperly narrowed the *temporal scope* of its analysis by focusing exclusively on the effects of Section 907(a)(1)(A) on domestic like products at the time the ban on flavoured cigarettes came into effect. The United States claims further that the Panel erred in finding that the less favourable treatment accorded to imported clove cigarettes was related to the origin of the products, because Section 907(a)(1)(A) imposes costs on foreign producers while at the same time imposing no costs on any US entity. Finally, the United States claims that the Panel acted inconsistently with Article 11 of the DSU in reaching these findings.

164. Indonesia responds that the Panel properly identified the products to be compared in its less favourable treatment analysis, and did not err in establishing the appropriate timeframe for its comparison. Indonesia also asserts that the Panel correctly found that the less favourable treatment accorded to clove cigarettes could not be explained by factors unrelated to the foreign origin of the imported products. Finally, Indonesia claims that the Panel acted in accordance with Article 11 of the DSU in performing its analysis.

165. Before turning to the specific issues raised by the United States on appeal, we find it useful to interpret the "treatment no less favourable" requirement of Article 2.1 of the *TBT Agreement* in the light of the conflicting interpretations of this phrase offered by the participants on appeal.

2. "Treatment No Less Favourable" under Article 2.1 of the TBT Agreement

166. Referring to the Appellate Body's interpretation of Article III:4 of the GATT 1994<sup>359</sup>, the United States and Indonesia agree that the "treatment no less favourable" standard of Article 2.1 of the *TBT Agreement* requires a panel to determine whether the technical regulation at issue modifies the conditions of competition in the relevant market to the detriment of the imported products. However, Indonesia considers that the existence of any detrimental effect on competitive opportunities for imported products is sufficient to establish less favourable treatment under Article 2.1.<sup>360</sup> In contrast, the United States argues that the existence of a detrimental effect on competitive opportunities for imports is necessary, but not sufficient, to establish a violation of Article 2.1. Referring to the Appellate Body report in *Dominican Republic – Import and Sale of Cigarettes*, the United States

<sup>359</sup>See Appellate Body Report, *Korea – Various Measures on Beef*, para. 137.

<sup>360</sup>Indonesia's appellee's submission, para. 172.

argues that Article 2.1 requires further inquiry into whether "the detrimental effect is explained by factors or circumstances unrelated to the foreign origin of the product".<sup>361</sup>

167. Article 2.1 of the *TBT Agreement* provides that, with respect to their central government bodies:

Members shall ensure that in respect of technical regulations, products imported from the territory of any Member shall be accorded treatment no less favourable than that accorded to like products of national origin and to like products originating in any other country.

168. As already set out above, for a violation of the national treatment obligation in Article 2.1 to be established, three elements must be satisfied: (i) the measure at issue must be a "technical regulation"; (ii) the imported and domestic products at issue must be like products; and (iii) the treatment accorded to imported products must be less favourable than that accorded to like domestic products. In this part of its appeal, the United States challenges only the Panel's finding that Section 907(a)(1)(A) of the FFDCA violates the national treatment obligation provided in Article 2.1 of the *TBT Agreement*, insofar as it accords to imported clove cigarettes less favourable treatment than that accorded to like domestic products.

169. The "treatment no less favourable" requirement of Article 2.1 of the *TBT Agreement* applies "in respect of technical regulations". A technical regulation is defined in Annex 1.1 thereto as a "[d]ocument which lays down product characteristics or their related processes and production methods ... with which compliance is mandatory". As such, technical regulations are measures that, by their very nature, establish distinctions between products according to their characteristics or their related processes and production methods. This suggests, in our view, that Article 2.1 should not be read to mean that *any* distinction, in particular those that are based *exclusively* on particular product characteristics or their related processes and production methods, would *per se* accord less favourable treatment within the meaning of Article 2.1.

170. We next observe that Article 2.2 of the *TBT Agreement* provides, in relevant part, that:

Members shall ensure that technical regulations are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade. For this purpose, technical regulations shall not be more trade-restrictive than necessary to fulfil a legitimate objective, taking account of the risks non-fulfilment would create.

171. The context provided by Article 2.2 suggests that "obstacles to international trade" may be permitted insofar as they are not found to be "unnecessary", that is, "more trade-restrictive than necessary to fulfil a legitimate objective". To us, this supports a reading that Article 2.1 does not operate to prohibit *a priori* any obstacle to international trade. Indeed, if *any* obstacle to international trade would be sufficient to establish a violation of Article 2.1, Article 2.2 would be deprived of its *effet utile*.

172. This interpretation of Article 2.1 is buttressed by the sixth recital of the preamble of the *TBT Agreement*, in which WTO Members recognize that:

... no country should be prevented from taking measures necessary to ensure the quality of its exports, or for the protection of human, animal, or plant life or health, of the environment, or for the prevention of deceptive practices, at the levels it considers appropriate, subject to the requirement that they are not applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on international trade, and are otherwise in accordance with the provisions of this Agreement.

173. The language of the sixth recital expressly acknowledges that Members may take measures necessary for, *inter alia*, the protection of human life or health, provided that such measures "are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination" or a "disguised restriction on international trade" and are "otherwise in accordance with the provisions of this Agreement". We consider that the sixth recital of the preamble of the *TBT Agreement* provides relevant context regarding the ambit of the "treatment no less favourable" requirement in Article 2.1, by making clear that technical regulations may pursue the objectives listed therein, provided that they are not applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, and are otherwise in accordance with the provisions of the *TBT Agreement*.

174. Finally, as noted earlier<sup>362</sup>, the object and purpose of the *TBT Agreement* is to strike a balance between, on the one hand, the objective of trade liberalization and, on the other hand, Members' right to regulate. This object and purpose therefore suggests that Article 2.1 should not be interpreted as prohibiting any detrimental impact on competitive opportunities for imports in cases where such detrimental impact on imports stems exclusively from legitimate regulatory distinctions.

175. Accordingly, the context and object and purpose of the *TBT Agreement* weigh in favour of reading the "treatment no less favourable" requirement of Article 2.1 as prohibiting both *de jure* and

<sup>361</sup>United States' appellant's submission, para. 101 (referring to Panel Report, para. 7.269; and Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 96).

<sup>362</sup>*Supra*, paras. 94 and 95.

*de facto* discrimination against imported products, while at the same time permitting detrimental impact on competitive opportunities for imports that stems exclusively from legitimate regulatory distinctions.

176. Like the participants, we also find it useful to consider the context provided by the other covered agreements. In particular, we note that the non-discrimination obligation of Article 2.1 of the *TBT Agreement* is expressed in the same terms as that of Article III:4 of the GATT 1994.<sup>363</sup> In the context of Article III:4, the "treatment no less favourable" requirement has been widely interpreted by previous GATT and WTO panels and by the Appellate Body. Beginning with the GATT panel in *US – Section 337 Tariff Act*, the term "treatment no less favourable" in Article III:4 was interpreted as requiring "effective equality of opportunities for imported products".<sup>364</sup> Subsequent GATT and WTO panels followed a similar approach, and found violations of Article III:4 in cases where regulatory distinctions in enforcement procedures<sup>365</sup>, distribution channels<sup>366</sup>, statutory content requirements<sup>367</sup>, and allocation of import licenses<sup>368</sup> resulted in alteration of the competitive opportunities in the market of the regulating Member to the detriment of imported products vis-à-vis domestic like products.

177. In *Korea – Various Measures on Beef*, the Appellate Body agreed that the analysis of less favourable treatment under Article III:4 focuses on the "conditions of competition" between imported and domestic like products.<sup>369</sup> The Appellate Body further clarified that a formal difference in treatment between imported and like domestic products is:

... neither necessary, nor sufficient, to show a violation of Article III:4. Whether or not imported products are treated "less favourably" than like domestic products should be assessed instead by examining whether a measure modifies the *conditions of competition* in the relevant market to the detriment of imported products.<sup>370</sup> (original emphasis)

178. Subsequently, in *EC – Asbestos*, the Appellate Body explained that imports will be treated less favourably than domestic like products when regulatory distinctions disadvantage the group of

<sup>363</sup> Article III:4 of the GATT 1994 reads:

The products of the territory of any Member imported into the territory of any other Member 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.

<sup>364</sup> GATT Panel Report, *US – Section 337 Tariff Act*, para. 5.10.

<sup>365</sup> GATT Panel Report, *US – Section 337 Tariff Act*, para. 5.20.

<sup>366</sup> GATT Panel Report, *Canada – Provincial Liquor Boards (US)*, paras. 5.12-5.16.

<sup>367</sup> Panel Report, *US – Gasoline*, para. 6.10.

<sup>368</sup> Panel Reports, *EC – Bananas III*, paras. 7.179-7.180.

<sup>369</sup> Appellate Body Report, *Korea – Various Measures on Beef*, para. 136.

<sup>370</sup> Appellate Body Report, *Korea – Various Measures on Beef*, para. 137.

imported products vis-à-vis the group of domestic like products. The Appellate Body reasoned that the "treatment no less favourable" clause of Article III:4:

... expresses the general principle, in Article III:1, that internal regulations "should not be applied ... so as to afford protection to domestic production." If there is "less favourable treatment" of the group of "like" imported products, there is, conversely, "protection" of the group of "like" domestic products. However, a Member may draw distinctions between products which have been found to be "like", without, for this reason alone, according to the group of "like" imported products "less favourable treatment" than that accorded to the group of "like" domestic products.<sup>371</sup> (original emphasis)

179. Thus, the "treatment no less favourable" standard of Article III:4 of the GATT 1994 prohibits WTO Members from modifying the conditions of competition in the marketplace to the detriment of the group of imported products vis-à-vis the group of domestic like products.<sup>372</sup>

180. Although we are mindful that the meaning of the term "treatment no less favourable" in Article 2.1 of the *TBT Agreement* is to be interpreted in the light of the specific context provided by the *TBT Agreement*, we nonetheless consider these previous findings by the Appellate Body in the context of Article III:4 of the GATT 1994 to be instructive in assessing the meaning of "treatment no less favourable", provided that the specific context in which the term appears in Article 2.1 of the *TBT Agreement* is taken into account. Similarly to Article III:4 of the GATT 1994, Article 2.1 of the *TBT Agreement* requires WTO Members to accord to the group of imported products treatment no less favourable than that accorded to the group of like domestic products. Article 2.1 prescribes such

<sup>371</sup> Appellate Body Report, *EC – Asbestos*, para. 100.

<sup>372</sup> We disagree with the United States to the extent that it suggests that *Dominican Republic – Import and Sale of Cigarettes* stands for the proposition that, under Article III:4, panels should inquire further whether "the detrimental effect is unrelated to the foreign origin of the product". (United States' appellant's submission, para. 101 (referring to Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 96)) Although the statement referred to by the United States, when read in isolation, could be viewed as suggesting that further inquiry into the rationale for the detrimental impact is necessary, in that dispute the Appellate Body rejected Honduras' claim under Article III:4 because:

... the difference between the per-unit costs of the bond requirement alleged by Honduras is explained by the fact that the importer of Honduran cigarettes has a smaller market share than two domestic producers (the per-unit cost of the bond requirement being the result of dividing the cost of the bond by the number of cigarettes sold on the Dominican Republic market).

(Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 96)

Thus, in that dispute, the Appellate Body merely held that the higher *per unit* costs of the bond requirement for imported cigarettes did not conclusively demonstrate less favourable treatment, because it was not attributable to the specific measure at issue but, rather, was a function of sales volumes. In *Thailand – Cigarettes (Philippines)*, the Appellate Body further clarified that for a finding of less favourable treatment under Article III:4 "there must be in every case a genuine relationship between the measure at issue and its adverse impact on competitive opportunities for imported versus like domestic products to support a finding that imported products are treated less favourably". (Appellate Body Report, *Thailand – Cigarettes (Philippines)*, para. 134) The Appellate Body eschewed an additional inquiry as to whether such detrimental impact was related to the foreign origin of the products or explained by other factors or circumstances.

treatment specifically in respect of technical regulations. For this reason, a panel examining a claim of violation under Article 2.1 should seek to ascertain whether the technical regulation at issue modifies the conditions of competition in the market of the regulating Member to the detriment of the group of imported products *vis-à-vis* the group of like domestic products.

181. However, as noted earlier, the context and object and purpose of the *TBT Agreement* weigh in favour of interpreting the "treatment no less favourable" requirement of Article 2.1 as not prohibiting detrimental impact on imports that stems exclusively from a legitimate regulatory distinction. Rather, for the aforementioned reasons<sup>373</sup>, the "treatment no less favourable" requirement of Article 2.1 only prohibits *de jure* and *de facto* discrimination against the group of imported products.

182. Accordingly, where the technical regulation at issue does not *de jure* discriminate against imports, the existence of a detrimental impact on competitive opportunities for the group of imported *vis-à-vis* the group of domestic like products is not dispositive of less favourable treatment under Article 2.1. Instead, a panel must further analyze whether the detrimental impact on imports stems exclusively from a legitimate regulatory distinction rather than reflecting discrimination against the group of imported products. In making this determination, a panel must carefully scrutinize the particular circumstances of the case, that is, the design, architecture, revealing structure, operation, and application of the technical regulation at issue, and, in particular, whether that technical regulation is even-handed, in order to determine whether it discriminates against the group of imported products.

### 3. Product Scope of the "Treatment No Less Favourable" Comparison

183. We now turn to the specific issues raised by the United States on appeal. We begin with the United States' appeal of the scope of products considered by the Panel to determine whether imported clove cigarettes are treated less favourably than US domestic like products within the meaning of Article 2.1 of the *TBT Agreement*.

184. Before the Panel, Indonesia argued that the "treatment no less favourable" requirement of Article 2.1 calls for a comparison between, on the one hand, treatment accorded to imported clove cigarettes and, on the other hand, treatment accorded to any like domestic cigarettes that are not banned by Section 907(a)(1)(A) of the FFDCA (that is, menthol or regular cigarettes, but not other flavoured cigarettes, which are prohibited under Section 907(a)(1)(A)).<sup>374</sup> The United States responded that the Panel should compare treatment accorded under Section 907(a)(1)(A) to all

imported cigarettes (to the extent they are like) and not just clove cigarettes, with the treatment accorded to all domestically produced like cigarettes.<sup>375</sup>

185. The Panel determined that the comparison should be between the treatment accorded to imported clove cigarettes and that accorded to the domestically produced cigarettes that it had earlier found to be like products, that is, menthol cigarettes. It reasoned that:

Article 2.1 of the *TBT Agreement* calls for a comparison of "products imported from the territory of any Member" with "like products of national origin". These provisions refer to the products imported from the territory of "any other Member", and not "Members" or "other Members" more generally. The imported products in this case are the products imported from the territory of *Indonesia*. And it appears to be common ground between the parties that the vast majority of cigarettes that were imported from Indonesia into the United States were *clove* cigarettes.<sup>376</sup> (original emphasis; footnote omitted)

On the domestic side, we recall that we have found that menthol cigarettes are "like" clove cigarettes for the purpose of Article 2.1 of the *TBT Agreement* because, *inter alia*, they both contain an additive that provides them with a characterizing flavour which makes them appealing to youth. We have not entered into an analysis of whether domestic regular cigarettes are "like" imported clove cigarettes as we consider that we would be exceeding our terms of reference.<sup>377</sup>

186. On appeal, the United States claims that the Panel erred in *a priori* limiting its less favourable treatment comparison to one imported product (Indonesian clove cigarettes) and one domestic like product (menthol cigarettes). Referring to the Appellate Body report in *EC – Asbestos* and the panel report in *US – Tuna II (Mexico)*, the United States argues that Article 2.1 required the Panel to compare the treatment accorded to all imported and domestic like products as a group.<sup>378</sup> For the United States, a proper comparison would have demonstrated that Section 907(a)(1)(A) does not alter the conditions of competition between imported and domestic like products as a group.<sup>379</sup>

187. With respect to the imported products, the United States argues that the Panel erred in failing to consider the treatment accorded to menthol cigarettes imported from other countries.<sup>380</sup> According to the United States, the reference to imported products of "any other Member" in Article 2.1 does not justify the Panel's focus on Indonesian clove cigarettes, because Article 2.1 aims at discerning

<sup>375</sup>Panel Report, para. 7.272.

<sup>376</sup>Panel Report, para. 7.275.

<sup>377</sup>Panel Report, para. 7.277.

<sup>378</sup>United States' appellant's submission, paras. 75-77 (referring to Appellate Body Report, *EC – Asbestos*, para. 100; and quoting Panel Report, *US – Tuna II (Mexico)*, para. 7.295).

<sup>379</sup>United States' appellant's submission, para. 81.

<sup>380</sup>United States' appellant's submission, para. 79.

<sup>373</sup>See *supra*, paras. 97-101.

<sup>374</sup>Panel Report, para. 7.271.

legitimate regulatory distinctions from those that serve as a proxy for singling out the like products of the complaining Member<sup>381</sup> for less favourable treatment.

188. With respect to like domestic products, the United States argues that the Panel erred in failing to consider the treatment accorded to domestic flavoured cigarettes.<sup>382</sup> To the extent that the Panel limited its analysis to domestic menthol cigarettes by virtue of the product scope of Indonesia's panel request, the United States maintains that a panel's terms of reference do not limit the scope of the products to be considered in a discrimination claim.<sup>383</sup>

189. For its part, Indonesia responds that the Panel did not err in comparing the treatment accorded to imported clove cigarettes with the treatment accorded to domestic menthol cigarettes. Indonesia argues that the Panel correctly limited its less favourable treatment comparison to those imported and domestic products that it reviewed in its likeness analysis.<sup>384</sup> Whereas the Appellate Body in *EC – Asbestos* and the panel in *US – Tuna II (Mexico)* engaged in a likeness analysis on the basis of groups of products, the Panel in this case correctly limited its analysis to the specific products at issue, namely, imported clove cigarettes and domestic menthol cigarettes.<sup>385</sup> Indonesia further maintains that the Panel did not rely on its terms of reference to limit the product scope of its less favourable treatment comparison, but rather on its determination of the scope of its likeness analysis.<sup>386</sup>

190. Article 2.1 provides that "products imported from the territory of any Member"<sup>387</sup> shall be accorded treatment no less favourable than that accorded to "like products of national origin and like products originating in any other country". The text of Article 2.1 thus calls for a comparison of treatment accorded to, on the one hand, products imported from any Member alleging a violation of Article 2.1, and treatment accorded to, on the other hand, like products of domestic and any other origin. Therefore, for the purposes of the less favourable treatment analysis, treatment accorded to products imported from the complaining Member is to be compared with that accorded to like domestic products and like products of any other origin.

191. In determining what are the "like products of national origin and like products originating in any other country", a panel must seek to establish, based on the nature and extent of the competitive relationship between the products in the market of the regulating Member, the products of domestic (and other) origin(s) that are like the products imported from the complaining Member. In

<sup>381</sup>United States' appellant's submission, para. 84.

<sup>382</sup>United States' appellant's submission, para. 79.

<sup>383</sup>United States' appellant's submission, para. 87.

<sup>384</sup>Indonesia's appellee's submission, paras. 138 and 139.

<sup>385</sup>Indonesia's appellee's submission, paras. 123-130.

<sup>386</sup>Indonesia's appellee's submission, paras. 147 and 148.

<sup>387</sup>Emphasis added.

determining what the like products at issue are, a panel is not bound by its terms of reference to limit its analysis to those products identified by the complaining Member in its panel request. Rather, Article 2.1 requires the panel to identify the domestic products that stand in a sufficiently close competitive relationship with the products imported from the complaining Member to be considered like products within the meaning of that provision.

192. To be clear, a panel's duty under Article 2.1 to identify the products of domestic and other origins that are like the products imported from the complaining Member does not absolve the complainant from making a *prima facie* case of violation of Article 2.1. Ordinarily, in discharging that burden, the complaining Member will identify the imported and domestic products that are allegedly like and whose treatment needs to be compared for purposes of establishing a violation of Article 2.1. The products identified by the complaining Member are the starting point in a panel's likeness analysis. However, Article 2.1 requires panels to assess objectively, on the basis of the nature and extent of the competitive relationship between the products in the market of the regulating Member, the universe of domestic products that are like the products imported from the complaining Member.<sup>388</sup>

193. Once the imported and domestic like products have been properly identified, Article 2.1 requires a panel dealing with a national treatment claim to compare, on the one hand, the treatment accorded under the technical regulation at issue to all like products imported from the complaining Member with, on the other hand, that accorded to all like domestic products. However, the national treatment obligation of Article 2.1 does not require Members to accord no less favourable treatment to each and every imported product as compared to each and every domestic like product. Article 2.1 does not preclude any regulatory distinctions between products that are found to be like, as long as treatment accorded to the *group* of imported products is no less favourable than that accorded to the *group* of like domestic products. As noted by the Appellate Body in the context of Article III:4 of the GATT 1994:

[A] Member may draw distinctions between products which have been found to be "like", without, for this reason alone, according to the group of "like" imported products "less favourable treatment" than that accorded to the group of "like" domestic products.<sup>389</sup> (original emphasis)

194. In sum, the national treatment obligation of Article 2.1 calls for a comparison of treatment accorded to, on the one hand, the group of products imported from the complaining Member and, on the other hand, the treatment accorded to the group of like domestic products. In determining what

<sup>388</sup>See Appellate Body Report, *EC and certain member States – Large Civil Aircraft*, para. 1131.

<sup>389</sup>Appellate Body Report, *EC – Asbestos*, para. 100.

the scope of like imported and domestic products is, a panel is not limited to those products specifically identified by the complaining Member. Rather, a panel must objectively assess, based on the nature and extent of their competitive relationship, what are the domestic products that are like the products imported from the complaining Member. Once the universe of imported and domestic like products has been identified, the treatment accorded to all like products imported from the complaining Member must be compared to that accorded to all like domestic products. The "treatment no less favourable" standard of Article 2.1 does not prohibit regulatory distinctions between products found to be like, provided that the group of like products imported from the complaining Member is treated no less favourably than the group of domestic like products.

195. Against this analytical framework, we turn to the United States' specific allegations of error. The United States essentially claims that the Panel impermissibly narrowed the scope of products to be compared for the purpose of assessing Indonesia's claim that Section 907(a)(1)(A) violates the national treatment obligation of Article 2.1.

196. With respect to the group of imported products, the United States claims that the Panel erred in failing to include in its analysis treatment accorded to menthol cigarettes imported into the United States from all Members. We cannot agree. As noted earlier, the national treatment obligation of Article 2.1 calls for a comparison of treatment accorded to the group of like products imported from the Member alleging a violation of Article 2.1, and treatment accorded to the group of like domestic products. It follows that the Panel did not err in finding that a determination of Indonesia's claims under Article 2.1 required an examination of whether Section 907(a)(1)(A) accords to the group of products imported *from Indonesia* less favourable treatment than that accorded to the group of like products of US origin.<sup>390</sup>

197. In determining the group of products imported from Indonesia whose treatment needed to be compared with the treatment accorded to like domestic products, the Panel found that it was uncontested that the "vast majority" of cigarettes that were imported from Indonesia into the United States were clove cigarettes.<sup>391</sup> The Panel also observed that only "a small percentage of non-clove cigarettes" was imported from Indonesia into the United States.<sup>392</sup> Accordingly, the Panel did not err in finding that the group of products imported from Indonesia essentially consisted of clove cigarettes.

198. With respect to the group of like domestic products, the United States' challenge focuses on the Panel's exclusion of domestically produced flavoured cigarettes from its less favourable treatment

<sup>390</sup>Panel Report, paras. 7.275-7.276.

<sup>391</sup>Panel Report, para. 7.275.

<sup>392</sup>Panel Report, footnote 503 to para. 7.275 (referring to United States' response to Panel Question 81, in turn referring to World Trade Atlas, Indonesia Cigarette Exports to the United States, 1998-2009 (Panel Exhibit US-134)).

analysis. The Panel felt bound by its terms of reference to limit its likeness analysis to two categories of products regulated under Section 907(a)(1)(A)—imported clove cigarettes and domestic menthol cigarettes<sup>393</sup>—and accordingly limited its less favourable treatment analysis to a comparison of the treatment accorded to those two product groups.<sup>394</sup> The Panel did not address domestic flavoured cigarettes at either the likeness or the less favourable treatment stage of its analysis.

199. We note, however, that the United States does not challenge on appeal the Panel's exclusion of domestically produced flavoured cigarettes from the likeness stage of its analysis. Rather, the United States' challenge focuses exclusively on the Panel's exclusion of domestically produced flavoured cigarettes from the less favourable treatment stage of the Panel's analysis. Because Article 2.1 expressly limits the scope of the less favourable treatment comparison to imported and domestic like products, in the absence of specific findings by the Panel that domestically produced flavoured cigarettes other than menthol are like clove cigarettes, we cannot determine whether the Panel erred in failing to include domestically produced flavoured cigarettes in its less favourable treatment comparison.

200. Even assuming, for the sake of argument, that the Panel had found that domestic flavoured cigarettes are like clove cigarettes imported from Indonesia, we are not persuaded that this would have changed the Panel's ultimate conclusion that Section 907(a)(1)(A) modifies the conditions of competition to the detriment of the group of imported products vis-à-vis like domestic products. Aside from the Panel's finding that, "at the time of the ban, there were no domestic cigarettes with characterizing flavours other than menthol cigarettes"<sup>395</sup> in the US market—which is challenged by the United States and addressed below—the Panel did not have evidence on the record that flavoured cigarettes other than menthol cigarettes had "any sizeable market share in the United States prior to the implementation of the ban in 2009".<sup>396</sup> To the contrary, in response to a Panel question, the United States confirmed that the non-clove-flavoured cigarettes banned under Section 907(a)(1)(A) "were on the market for a relatively short period of time and represented a relatively small market share".<sup>397</sup> Therefore, we consider it safe to assume that, given their relatively low share in the US market, the inclusion of domestically produced flavoured cigarettes in the comparison would not have altered the Panel's ultimate conclusion that the group of like domestic products essentially consisted of domestic menthol cigarettes.

<sup>393</sup>Panel Report, para. 7.147.

<sup>394</sup>Panel Report, para. 7.277.

<sup>395</sup>Panel Report, para. 7.289.

<sup>396</sup>Panel Report, para. 2.28.

<sup>397</sup>United States' response to Panel Question 17, para. 43.

4. Temporal Scope of the "Treatment No Less Favourable" Comparison

201. To the extent that the Panel's exclusion of domestic flavoured cigarettes other than menthol cigarettes from its analysis stemmed from its finding that those products were not on the market at the time when the ban came into effect, the United States submits that this constitutes legal error. In particular, the United States claims that the Panel erred in *a priori* excluding from its analysis evidence concerning the effects of Section 907(a)(1)(A) of the FFDCA on domestic like products prior to the entry into force of the ban on flavoured cigarettes. Moreover, the United States claims that the Panel acted inconsistently with Article 11 of the DSU in ignoring evidence demonstrating that there were domestic flavoured cigarettes other than menthol cigarettes on the US market at the time of the ban.<sup>398</sup>

(a) Application of Article 2.1 of the *TBT Agreement*

202. The United States argues that Article 2.1 of the *TBT Agreement* does not establish a rigid temporal limitation in relation to the evidence that a panel may consider in performing a less favourable treatment analysis. For this reason, the United States argues that the Panel should have taken into account evidence demonstrating that there were domestically produced flavoured cigarettes on the market "in the years closely preceding the effective date of the ban".<sup>399</sup> Section 907(a)(1)(A) was enacted specifically to respond to an "emerging trend of products", and closed off a "potential market" that US producers were actively exploring as recently as 2008.<sup>400</sup> Therefore, the fact that the ban on flavoured cigarettes went into effect before US producers were able to "saturate" the market with those products should not be construed as evidence that US producers were not affected by the ban.<sup>401</sup>

203. Indonesia responds that the United States' appeal of the relevant timeframe for the Panel's analysis is irrelevant, because the Panel properly compared only the treatment accorded to the products found to be like in this dispute—imported clove and domestic menthol cigarettes—both of which were on the market before the ban went into effect.<sup>402</sup> Indonesia agrees with the United States that Article 2.1 establishes "no rigid temporal limitation" on the timeframe of the analysis, and affords panels discretion in selecting the appropriate period.<sup>403</sup>

<sup>398</sup>United States' appellant's submission, paras. 97 and 98.

<sup>399</sup>United States' appellant's submission, para. 92.

<sup>400</sup>United States' appellant's submission, para. 93.

<sup>401</sup>United States' appellant's submission, para. 94.

<sup>402</sup>Indonesia's appellee's submission, para. 151.

<sup>403</sup>Indonesia's appellee's submission, para. 152 (quoting United States' appellant's submission, para. 92).

204. The United States' challenge is directed at the Panel's statement that:

... at the time of the ban, there were no domestic cigarettes with characterizing flavours other than menthol cigarettes which accounted for approximately 25 per cent of the market and for a very significant proportion of the cigarettes smoked by youth in the United States. (emphasis added; footnote omitted)

205. In the present dispute, the Panel's mandate was established by its terms of reference, as defined in Indonesia's panel request. These terms of reference required the Panel to determine whether Section 907(a)(1)(A) was consistent with various provisions of the *TBT Agreement* and of the GATT 1994 at the date of the Panel's establishment. Accordingly, the Panel was required to assess whether there existed a violation of those Agreements at that time and, if so, to make a recommendation that the United States bring its measure into compliance. It follows that, in relation to Indonesia's claim under Article 2.1 of the *TBT Agreement*, the Panel was required to assess, as of the date of its establishment, whether Section 907(a)(1)(A) is a technical regulation that accords to products imported from Indonesia less favourable treatment than that accorded to like domestic products.

206. We agree with the participants that Article 2.1 does not establish a rigid temporal limitation on the evidence that the Panel could review in assessing Indonesia's claim under Article 2.1. Nothing in Article 2.1 enjoins panels from taking into account evidence pre-dating the establishment of a panel to the extent that such evidence informs the panel's assessment of the consistency of the measure at that point in time. This is particularly so in the case of a *de facto* discrimination claim, where a panel must base its determination on the totality of facts and circumstances before it, including the design, architecture, revealing structure, operation, and application of the technical regulation at issue. Therefore, evidence that Section 907(a)(1)(A) had "chilling" regulatory effects on domestic producers of flavoured cigarettes prior to the entry into force of the ban on those cigarettes could be relevant in the Panel's assessment of Indonesia's claim under Article 2.1.

207. In the present dispute, it is not clear that the Panel considered Article 2.1 to prohibit review of evidence pre-dating the entry into force of Section 907(a)(1)(A). As noted earlier, the Panel did not explain why it did not include domestic flavoured cigarettes other than menthol cigarettes in the group of like domestic products. In any event, the Panel's statement that, "at the time of the ban, there were no domestic cigarettes with characterizing flavours other than menthol" on the US market, was not the basis for the Panel's exclusion of domestic flavoured cigarettes from the less favourable treatment analysis. Rather, it was the basis for its finding that Section 907(a)(1)(A) imposes "costs on producers in other Members, notably producers in Indonesia, while at the same time imposing no costs on any

US entity."<sup>404</sup> This finding by the Panel is challenged by the United States on appeal, and addressed in subsection V.C.5 of this Report.

(b) Article 11 of the DSU

208. The United States claims that the Panel acted inconsistently with Article 11 of the DSU in disregarding evidence demonstrating that, *at the time of the ban*, domestic flavoured cigarettes other than menthol cigarettes were marketed in the United States.<sup>405</sup>

209. Indonesia responds that the Panel did consider the evidence submitted by the United States in this regard but was ultimately not persuaded by it.<sup>406</sup> According to Indonesia, in weighing the evidence before it, the Panel did not act inconsistently with Article 11 of the DSU.

210. We recall that Article 11 of the DSU requires a panel to "consider all the evidence presented to it, assess its credibility, determine its weight, and ensure that its factual findings have a proper basis in that evidence".<sup>407</sup> Within these parameters, "it is generally within the discretion of the [p]anel to decide which evidence it chooses to utilize in making findings"<sup>408</sup>, and panels "are not required to accord to factual evidence of the parties the same meaning and weight as do the parties".<sup>409</sup>

211. We observe that, in finding that "at the time of the ban there were no domestic cigarettes with characterizing flavours other than menthol cigarettes which accounted for 25 per cent of the market"<sup>410</sup>, the Panel noted:

The United States argues that there is evidence showing that U.S.-produced cigarettes with characterizing flavours were on the market in 2008 and 2009 (United States' second written submission, para. 132). In this regard, the United States points to exhibits US-52 and US-62. In our view, none of the exhibits submitted demonstrate that U.S.-produced flavour cigarettes were being sold on the market as of the entry into force of Section 907(a)(1)(A). Exhibit US-52 only contains the "known and possible 'flavored' cigarette brands sold in the United States" as of 2008. Thus, it does not shed light upon the brands of cigarettes present in the U.S. market at the time Section 907(a)(1)(A) entered into force. Exhibit US-62 lists the flavoured cigarette brands that were certified as "fire-safe" brands in the States of New York and Maine as of 2009. Although this exhibit

<sup>406</sup>Panel Report, para. 7.289.

<sup>405</sup>United States' appellant's submission, paras. 97 and 98.

<sup>406</sup>Indonesia's appellee's submission, paras. 158 and 162.

<sup>407</sup>Appellate Body Reports, *Philippines – Distilled Spirits*, para. 135 (quoting Appellate Body Report, *Brazil – Retreaded Tyres*, para. 185, in turn referring to Appellate Body Report, *EC – Hormones*, paras. 132 and 133).

<sup>408</sup>Appellate Body Report, *EC – Hormones*, para. 135.

<sup>409</sup>Appellate Body Report, *Australia – Salmon*, para. 267.

<sup>410</sup>Panel Report, para. 7.289.

extends until the entry into force of Section 907(a)(1)(A), it does not demonstrate which brands and types of cigarettes were actually being sold on the U.S. market on that date. Rather, it merely lists the brands of cigarettes certified as "fire-safe". We therefore stand by our conclusion.<sup>411</sup>

212. Thus, it appears that the Panel did not disregard the evidence that, according to the United States, demonstrated the presence of domestically produced flavoured cigarettes other than menthol cigarettes on the US market at the time of the ban. Rather, the Panel reviewed that evidence but was ultimately not persuaded by it. In determining the weight to be attributed to the evidence before it, the Panel did not act inconsistently with Article 11 of the DSU. In particular, the Panel did not exceed its authority under Article 11 of DSU merely by attributing to the evidence a weight and significance different from that attributed to it by the United States.

#### 5. Detrimental Impact on Imported Products

213. Finally, the United States claims that, even if the Appellate Body were to agree with the comparison undertaken by the Panel in its less favourable treatment analysis, the Panel nonetheless erred in finding that the detrimental effect on competitive opportunities for imported clove cigarettes was not "explained by factors unrelated to the foreign origin of those products".<sup>412</sup>

214. The United States does not challenge on appeal the Panel's findings that Section 907(a)(1)(A) of the FFDCA accords different treatment to imported clove cigarettes and to domestic menthol cigarettes, and that such differential treatment is to the detriment of the imported product, insofar as clove cigarettes are banned while menthol cigarettes are permitted.<sup>413</sup> Accordingly, the Panel's conclusion that Section 907(a)(1)(A) modifies the conditions of competition in the US market to the detriment of imported clove cigarettes stands.

215. However, as noted earlier<sup>414</sup>, the existence of a detrimental impact on competitive opportunities in the relevant market for the group of imported products vis-à-vis the group of domestic like products is not sufficient to establish a violation of the national treatment obligation contained in Article 2.1 of the *TBT Agreement*. Where the technical regulation at issue does not *de jure* discriminate against imports, a panel must carefully scrutinize the particular circumstances of the case, that is, the design, architecture, revealing structure, operation, and application of the technical regulation at issue, and, in particular, whether that technical regulation is even-handed, in

<sup>411</sup>Panel Report, footnote 524 to para. 7.289.

<sup>412</sup>United States' appellant's submission, para. 99 (referring to Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 96).

<sup>413</sup>Panel Report, paras. 7.279-7.281.

<sup>414</sup>See *supra*, paras. 174 and 175.

order to determine whether the detrimental impact on imports stems exclusively from a legitimate regulatory distinction rather than reflects discrimination against the group of imported products.

216. Before the Panel, the United States argued that the exemption of menthol cigarettes from the ban on flavoured cigarettes is unrelated to the origin of the products, because it addresses two distinct objectives: one relates to the potential impact on the US health care system associated with the need to treat "millions" of menthol cigarette addicts with withdrawal symptoms; and the other relates to the risk of development of a black market and smuggling to supply the needs of menthol cigarette smokers.<sup>415</sup>

217. The Panel considered that "the potential impact on the health care system and the potential development of a black market and smuggling of menthol cigarettes"<sup>416</sup> did not constitute legitimate objectives, because:

These reasons which the United States has presented as constituting a legitimate objective by themselves, appear to us as relating in one way or another to the costs that might be incurred by the United States were it to ban menthol cigarettes. Indeed, the United States is not banning menthol cigarettes because it is not a type of cigarette with a characterizing flavour that appeals to youth, but rather because of the costs that might be incurred as a result of such a ban. We recall that at the time of the ban, there were no domestic cigarettes with characterizing flavours other than menthol cigarettes which accounted for approximately 25 per cent of the market and for a very significant proportion of the cigarettes smoked by youth in the United States. It seems to us that the effect of banning cigarettes with characterizing flavours other than menthol is to impose costs on producers in other Members, notably producers in Indonesia, while at the same time imposing no costs on any U.S. entity.<sup>417</sup> (footnotes omitted)

218. On appeal, the United States claims that the Panel erred in concluding that any detriment to the competitive opportunities for imported clove cigarettes could not be explained by factors unrelated to the foreign origin of the products.<sup>418</sup> In addition, the United States claims that the Panel failed to make an objective assessment of the matter under Article 11 of the DSU in finding that there were no costs imposed on any US entity.<sup>419</sup>

(a) Application of Article 2.1

219. We begin with the United States' claim that the Panel erred in concluding that any detriment to the competitive opportunities for imported clove cigarettes could not be explained by factors unrelated to the foreign origin of the products.<sup>420</sup> The United States argues that, "even where a technical regulation adversely affects the competitive situation of imported products compared to like domestic products, this does not constitute less favourable treatment when the detrimental effect is unrelated to the foreign origin of the product."<sup>421</sup> According to the United States, many factors affect the costs associated with a technical regulation, such as transportation costs, production methods, the age of the producer's facility, size, efficiency, productivity, and marketing strategy. As a result, Article 2.1 does not prohibit the imposition of costs on imported products as compared to domestic products, where those costs are not related to the origin of the product.<sup>422</sup> The Panel did not examine the "architecture, structure and design" of Section 907(a)(1)(A), including the fact that it allows Indonesia to import and sell regular and menthol cigarettes in the United States.<sup>423</sup> For the United States, reference to unspecified "costs" on foreign producers does not establish that the effects of Section 907(a)(1)(A) on competitive opportunities for imported products are related to their origin.<sup>424</sup> The United States underscores that the costs that Section 907(a)(1)(A) allegedly avoids would be incurred by the US regulatory enforcement and health care systems (and not by domestic menthol cigarette producers), even if all menthol cigarettes were imported.<sup>425</sup>

220. For Indonesia, the Panel's finding that Section 907(a)(1)(A) modifies the conditions of competition in the United States to the detriment of imported clove cigarettes vis-à-vis domestic menthol cigarettes was sufficient to establish a violation of Article 2.1.<sup>426</sup> Although Indonesia maintains that an additional "national origin" test was not required, Indonesia argues that, nevertheless, the Panel was correct in concluding that Section 907(a)(1)(A) had a "discriminatory intent", because menthol cigarettes accounted for 25 per cent of the market, and for a significant proportion of the cigarettes smoked by youth in the United States.<sup>427</sup> The Panel correctly rejected the potential costs on the US health care and enforcement systems as "legitimate reasons" for exempting menthol cigarettes from the ban on flavoured cigarettes. The Panel also appropriately found that the

<sup>420</sup>United States' appellant's submission, para. 99.

<sup>421</sup>United States' appellant's submission, para. 101.

<sup>422</sup>United States' appellant's submission, para. 101.

<sup>423</sup>United States' appellant's submission, para. 103.

<sup>424</sup>United States' appellant's submission, para. 106.

<sup>425</sup>United States' appellant's submission, para. 107.

<sup>426</sup>Indonesia's appellee's submission, para. 172.

<sup>427</sup>Indonesia's appellee's submission, para. 183.

<sup>415</sup>Panel Report, para. 7.289 and footnote 522 thereto.

<sup>416</sup>Panel Report, para. 7.289.

<sup>417</sup>Panel Report, para. 7.289.

<sup>418</sup>United States' appellant's submission, para. 99.

<sup>419</sup>United States' appellant's submission, para. 109.

disproportionate allocation of costs between Indonesian and US entities evidenced *de facto* discrimination against imports.<sup>428</sup>

221. At the outset, we agree with the United States that the Panel did not clearly articulate its reasons for concluding that "the effect of banning cigarettes with characterizing flavours other than menthol is to impose costs on producers in other Members, notably producers in Indonesia, while at the same time imposing no costs on any US entity."<sup>429</sup> To the extent that actual or potential costs are relevant to the analysis of less favourable treatment under Article 2.1, the Panel did not elaborate on why, in its view, Section 907(a)(1)(A) does not impose costs "on any US entity" beyond observing that, "at the time of the ban, there were no domestic cigarettes with characterizing flavours other than menthol cigarettes"<sup>430</sup> on the US market.<sup>431</sup>

222. Nonetheless, we are not persuaded that the Panel erred in ultimately finding that Section 907(a)(1)(A) is inconsistent with Article 2.1. By design, Section 907(a)(1)(A) prohibits all cigarettes with characterizing flavours other than tobacco or menthol. In relation to the cigarettes that are banned under Section 907(a)(1)(A), the Panel made a factual finding that "virtually all clove cigarettes" that were imported into the United States in the three years prior to the ban came from Indonesia.<sup>432</sup> The Panel also noted that the "vast majority" of clove cigarettes consumed in the United States came from Indonesia.<sup>433</sup> Although the United States stated that it was "unable to attain market share data for all non-clove products banned under Section 907(a)(1)(A)"<sup>434</sup>, the Panel did not find evidence that these products had "any sizeable market share in the United States prior to the implementation of the ban in 2009".<sup>435</sup> In response to a Panel question, the United States confirmed that non-clove-flavoured cigarettes banned under Section 907(a)(1)(A) "were on the market for a relatively short period of time and represented a relatively small market share".<sup>436</sup>

<sup>428</sup>Indonesia's appellee's submission, paras. 184-185.

<sup>429</sup>Panel Report, para. 7.289.

<sup>430</sup>Panel Report, para. 7.289.

<sup>431</sup>Moreover, to the extent that the Panel's finding could be read as suggesting that reducing potential costs of regulation *per se* constitutes an illegitimate regulatory objective, we disagree. Nothing in Article 2.1 prevents a Member from seeking to minimize the potential costs arising from technical regulations, provided that the technical regulation at issue does not overtly or covertly discriminate against imports.

<sup>432</sup>Panel Report, para. 2.26 (referring to Indonesia's first written submission to the Panel, para. 18; United States' first written submission to the Panel, para. 35; World Trade Atlas, United States – Imports, Clove Cigarette Market Share Data (Panel Exhibit US-100); and World Trade Atlas, Indonesia Cigarette Exports to the United States, 1998-2009 (Panel Exhibit US-134)).

<sup>433</sup>Panel Report, para. 2.27. The Panel nonetheless was able to identify at least one US company that manufactured clove cigarettes prior to the entry into force of the FSPICA. (*Ibid.* (referring to United States' first written submission to the Panel, para. 35))

<sup>434</sup>Panel Report, footnote 58 to para. 2.28.

<sup>435</sup>Panel Report, para. 2.28.

<sup>436</sup>United States' response to Panel Question 17, para. 43.

223. With respect to the cigarettes that are *not* banned under Section 907(a)(1)(A), the record demonstrates that, in the years 2000 to 2009, between 94.3 and 97.4 per cent of all cigarettes sold in the United States were domestically produced<sup>437</sup>, and that menthol cigarettes accounted for about 26 per cent of the total US cigarette market.<sup>438</sup> Information on the record also shows that three domestic brands dominate the US market for menthol cigarettes: Kool, Salem (Reynolds American), and Newport (Lorillard), with Marlboro having a smaller market share.<sup>439</sup>

224. Given the above, the design, architecture, revealing structure, operation, and application of Section 907(a)(1)(A) strongly suggest that the detrimental impact on competitive opportunities for clove cigarettes reflects discrimination against the group of like products imported from Indonesia. The products that are prohibited under Section 907(a)(1)(A) consist primarily of clove cigarettes imported from Indonesia, while the like products that are actually permitted under this measure consist primarily of domestically produced menthol cigarettes.

225. Moreover, we are not persuaded that the detrimental impact of Section 907(a)(1)(A) on competitive opportunities for imported clove cigarettes does stem from a legitimate regulatory distinction. We recall that the stated objective of Section 907(a)(1)(A) is to reduce youth smoking. One of the particular characteristics of flavoured cigarettes that makes them appealing to young people is the flavouring that masks the harshness of the tobacco, thus making them more pleasant to start smoking than regular cigarettes.<sup>440</sup> To the extent that this particular characteristic is present in both clove and menthol cigarettes<sup>441</sup>, menthol cigarettes have the same product characteristic that, from the perspective of the stated objective of Section 907(a)(1)(A), justified the prohibition of clove cigarettes. Furthermore, the reasons presented by the United States for the exemption of menthol cigarettes from the ban on flavoured cigarettes do not, in our view, demonstrate that the detrimental impact on competitive opportunities for imported clove cigarettes does stem from a legitimate regulatory distinction. The United States argues that the exemption of menthol cigarettes from the ban on flavoured cigarettes aims at minimizing: (i) the impact on the US health care system associated with treating "millions" of menthol cigarette smokers affected by withdrawal symptoms;

<sup>437</sup>Cigarettes: Domestic and Imported, 2000-2009 (Panel Exhibit US-31).

<sup>438</sup>United States' first written submission to the Panel, para. 27 (referring to US Federal Trade Commission, *Cigarette Report for 2006*, Table 1A (2009) (Panel Exhibit US-29); and P.S. Gardiner, "The African Americanization of menthol cigarette use in the United States" (February 2004) 6(1) *Nicotine & Tobacco Research* S55 (Panel Exhibit US-30)).

<sup>439</sup>See United States' first written submission to the Panel, para. 29 and P.S. Gardiner, "The African Americanization of menthol cigarette use in the United States" (February 2004) 6(1) *Nicotine & Tobacco Research* S55 (Panel Exhibit US-30), p. 58.

<sup>440</sup>Panel Report, paras. 7.216-7.221.

<sup>441</sup>Panel Report, para. 7.221 (referring to "Use of Menthol Cigarettes", The National Survey on Drug Use and Health Report, 19 November 2009 (Panel Exhibit IND-66); and American Lung Association, Tobacco Policy Trend Alert, *From Joe Camel to Kauai Kolada – the Marketing of Candy-Flavored Cigarettes* (2006) (Panel Exhibit US-35), p. 1, available at <<http://slati.lungusa.org/reports/CandyFlavoredUpdatedAlert.pdf>>).

and (ii) the risk of development of a black market and smuggling of menthol cigarettes to supply the needs of menthol cigarette smokers. Thus, according to the United States, the exemption of menthol cigarettes from the ban on flavoured cigarettes is justified in order to avoid risks arising from withdrawal symptoms that would afflict menthol cigarette smokers in case those cigarettes were banned. We note, however, that the additive ingredient in menthol cigarettes is nicotine, not peppermint or any other ingredient that is exclusively present in menthol cigarettes, and that this ingredient is also present in a group of products that is likewise permitted under Section 907(a)(1)(A), namely, regular cigarettes. Therefore, it is not clear that the risks that the United States claims to minimize by allowing menthol cigarettes to remain in the market would materialize if menthol cigarettes were to be banned, insofar as regular cigarettes would remain in the market.

226. Therefore, even though Section 907(a)(1)(A) does not expressly distinguish between treatment accorded to the imported and domestic like products, it operates in a manner that reflects discrimination against the group of like products imported from Indonesia. Accordingly, despite our reservations on the brevity of the Panel's analysis, we agree with the Panel that, by exempting menthol cigarettes from the ban on flavoured cigarettes, Section 907(a)(1)(A) accords to clove cigarettes imported from Indonesia less favourable treatment than that accorded to domestic like products, within the meaning of Article 2.1 of the *TBT Agreement*.

(b) Article 11 of the DSU

227. Finally, the United States argues that the Panel acted inconsistently with Article 11 of the DSU because it found that Section 907(a)(1)(A) avoids costs on any US entity, in the absence of any basis in the Panel record that would have allowed it to reach such conclusion.<sup>442</sup> The United States argues that the measure imposed enforcement costs on the United States Food and Drug Administration (the "FDA"), and on domestic producers of cigarettes with characterizing flavours whose potential market was closed off. By reducing youth smoking, Section 907(a)(1)(A) also reduces subsequent demand for cigarettes. Therefore, it also shrinks the "adult" cigarette market, which is comprised almost entirely of domestic producers.<sup>443</sup>

228. Indonesia responds that the Panel did not act inconsistently with Article 11 of the DSU in reaching its finding, which is supported by evidence showing that the exemption of menthol cigarettes from the ban was the result of a political compromise with the US tobacco industry.<sup>444</sup>

<sup>442</sup>United States' appellant's submission, para. 110.

<sup>443</sup>United States' appellant's submission, para. 111.

<sup>444</sup>Indonesia's appellee's submission, para. 189.

229. We recall that, in *EC – Fasteners (China)*, the Appellate Body considered that "[i]t is ... unacceptable for a participant effectively to recast its arguments before the panel under the guise of an Article 11 claim" and that "a claim that a panel failed to comply with its duties under Article 11 of the DSU must stand by itself and should not be made merely as a subsidiary argument or claim in support of a claim that the panel failed to apply correctly a provision of the covered agreements."<sup>445</sup> With these considerations in mind, we turn to review the United States' appeal that the Panel acted inconsistently with Article 11 of the DSU in finding that Section 907(a)(1)(A) imposed no costs on any US entity.

230. As noted above, we believe that the Panel did not fully explain the basis for the statement that Section 907(a)(1)(A), while imposing "costs" on foreign producers, imposed "no costs on any US entity". However, the Panel's statement should be read in the light of the fact that, in paragraph 7.289 of its Report, the Panel considered the costs imposed on producers "at the time of the ban" and that it equated the concept of "entity" with that of "producer", thus comparing the costs imposed on producers in Indonesia with the costs imposed on US producers, to the exclusion of government entities such as the FDA.

231. It seems to us that the United States' claim is concerned with the Panel's less favourable treatment comparison, rather than with the alleged absence of evidence in the Panel record justifying the lack of costs on any US entity. We note that the United States argues that the Panel erred, under Article 2.1 of the *TBT Agreement*, in limiting the scope of its less favourable treatment analysis to the effects of Section 907(a)(1)(A) on all domestic cigarettes at the time the measure entered into force, to the exclusion of flavoured cigarettes that were produced in the United States before the ban came into force.<sup>446</sup> In our view, the United States' argument that the Panel erred in not considering the impact of Section 907(a)(1)(A) on US producers before the entry into force of the ban also implies that the Panel was wrong in stating that the measure imposed no costs on any US producers. We thus consider that the claim by the United States that the Panel violated Article 11 of the DSU because it found that Section 907(a)(1)(A) imposed "no costs on any US entity" is subsidiary to its claim that the Panel erred in concluding that Section 907(a)(1)(A) accords less favourable treatment to imported clove cigarettes than to like menthol cigarettes of national origin within the meaning of Article 2.1 of the *TBT Agreement*.

232. In the light of the above, we do not consider that the Panel acted inconsistently with Article 11 of the DSU in finding that Section 907(a)(1)(A) accords imported clove cigarettes less

<sup>445</sup>Appellate Body Report, *EC – Fasteners (China)*, para. 442. See also Appellate Body Report, *US – Steel Safeguards*, para. 498; and Appellate Body Report, *Chile – Price Band System (Article 21.5 – Argentina)*, para. 238.

<sup>446</sup>United States' appellant's submission, para. 96.

favourable treatment than that accorded to domestic menthol cigarettes, within the meaning of Article 2.1 of the *TBT Agreement*.

6. Conclusion on "Treatment No Less Favourable"

233. Given the above, we *uphold*, albeit for different reasons, the Panel's finding, in paragraph 7.292 of the Panel Report, that, by banning clove cigarettes while exempting menthol cigarettes from the ban, Section 907(a)(1)(A) of the FFDCA accords imported clove cigarettes less favourable treatment than that accorded to domestic menthol cigarettes, within the meaning of Article 2.1 of the *TBT Agreement*.

D. *Conclusions under Article 2.1 of the TBT Agreement*

234. In the light of the foregoing considerations with regard to the Panel's findings on likeness and less favourable treatment, we therefore *uphold*, albeit for different reasons, the Panel's finding, in paragraphs 7.293 and 8.1(b) of the Panel Report, that Section 907(a)(1)(A) of the FFDCA is inconsistent with Article 2.1 of the *TBT Agreement* because it accords to imported clove cigarettes less favourable treatment than that accorded to like menthol cigarettes of national origin.

235. In reaching this conclusion, we wish to clarify the implications of our decision. We do not consider that the *TBT Agreement* or any of the covered agreements is to be interpreted as preventing Members from devising and implementing public health policies generally, and tobacco-control policies in particular, through the regulation of the content of tobacco products, including the prohibition or restriction on the use of ingredients that increase the attractiveness and palatability of cigarettes for young and potential smokers. Moreover, we recognize the importance of Members' efforts in the World Health Organization on tobacco control.

236. While we have upheld the Panel's finding that the specific measure at issue in this dispute is inconsistent with Article 2.1 of the *TBT Agreement*, we are not saying that a Member cannot adopt measures to pursue legitimate health objectives such as curbing and preventing youth smoking. In particular, we are not saying that the United States cannot ban clove cigarettes: however, if it chooses to do so, this has to be done consistently with the *TBT Agreement*. Although Section 907(a)(1)(A) pursues the legitimate objective of reducing youth smoking by banning cigarettes containing flavours and ingredients that increase the attractiveness of tobacco to youth, it does so in a manner that is inconsistent with the national treatment obligation in Article 2.1 of the *TBT Agreement* as a result of the exemption of menthol cigarettes, which similarly contain flavours and ingredients that increase the attractiveness of tobacco to youth, from the ban on flavoured cigarettes.

VI. **Article 2.12 of the TBT Agreement**

A. *Introduction*

237. We turn now to the United States' appeal of the Panel's finding that, by failing to allow a period of not less than six months between the publication and the entry into force of Section 907(a)(1)(A) of the FFDCA, the United States acted inconsistently with Article 2.12 of the *TBT Agreement*.

238. The FSPTCA was enacted on 22 June 2009. The measure at issue, Section 907(a)(1)(A), entered into force three months thereafter. Before the Panel, Indonesia argued that paragraph 5.2 of the Doha Ministerial Decision on Implementation-Related Issues and Concerns<sup>447</sup> ("the Doha Ministerial Decision")—which defined the term "reasonable interval" in Article 2.12 of the *TBT Agreement* as at least six months—constitutes a legally binding interpretation pursuant to Article IX:2 of the *WTO Agreement*. Thus, according to Indonesia, by not allowing a reasonable interval of at least six months between the publication and the entry into force of Section 907(a)(1)(A), the United States acted inconsistently with its obligations under Article 2.12 of the *TBT Agreement*.<sup>448</sup> The Panel framed the question before it as whether the United States acted inconsistently with its obligations under Article 2.12 by allowing an interval of three months between the enactment of the FSPTCA and the entry into force of Section 907(a)(1)(A). In particular, the Panel considered whether, as Indonesia claimed, Article 2.12 "obliged the United States to allow *as a minimum* a period of *six months* between the publication and the entry into force of Section 907(a)(1)(A)".<sup>449</sup>

239. In its analysis of Indonesia's claim under Article 2.12 of the *TBT Agreement*, the Panel considered the interpretative value of paragraph 5.2 of the Doha Ministerial Decision. The Panel took the view that, although the United States and Indonesia disagreed on the categorization of paragraph 5.2 as an authoritative interpretation under Article IX:2 of the *WTO Agreement*, it would "be guided by [the Doha Ministerial Decision] in its interpretation of the phrase 'reasonable interval' as [the Doha Ministerial Decision] was agreed by all WTO Members meeting in the form of Ministerial Conference, the highest ranking body of the WTO". Moreover, the Panel stated that, in its view, "paragraph 5.2 of the Doha Ministerial Decision could be considered as a subsequent agreement

<sup>447</sup>Decision of 14 November 2001, WT/MIN(01)/17, para. 5.2.

<sup>448</sup>Panel Report, para. 7.552.

<sup>449</sup>Panel Report, para. 7.561. (original emphasis)

of the parties", within the meaning of Article 31(3)(a) of the *Vienna Convention*, on the interpretation of the term "reasonable interval" in Article 2.12 of the *TBT Agreement*.<sup>450</sup>

240. The United States claims on appeal that: (i) the Panel attributed an incorrect "interpretative value" to paragraph 5.2 of the Doha Ministerial Decision in its interpretation of Article 2.12 of the *TBT Agreement*; and (ii) the Panel erred in finding that Indonesia had established a *prima facie* case of inconsistency with Article 2.12 of the *TBT Agreement*, that the United States failed to rebut.

B. *The Interpretative Value of Paragraph 5.2 of the Doha Ministerial Decision*

241. We recall that, with regard to the interpretative value of paragraph 5.2 of the Doha Ministerial Decision, the Panel stated that it "must be guided by [paragraph 5.2] in its interpretation of the phrase 'reasonable interval', as [paragraph 5.2] was agreed by all WTO Members meeting in the form of Ministerial Conference, the highest ranking body of the WTO".<sup>451</sup>

242. According to the United States, the Panel "declined to formally determine" whether paragraph 5.2 constitutes an authoritative interpretation of Article 2.12, "only saying that it 'must be guided' by paragraph 5.2" because it was agreed by all WTO Members meeting in the form of Ministerial Conference, the highest ranking body of the WTO.<sup>452</sup> The United States submits that, despite not having found that paragraph 5.2 has the legal status of an authoritative interpretation adopted pursuant to Article IX:2 of the *WTO Agreement*, the Panel erred by applying paragraph 5.2 as a "rule" that amended the text of Article 2.12 of the *TBT Agreement*.<sup>453</sup> The United States claims that the legal value of paragraph 5.2 is at most a supplementary means of interpretation within the meaning of Article 3.2 of the *Vienna Convention*.<sup>454</sup>

243. Indonesia responds that "the Panel *did* establish that paragraph 5.2 of the Doha Ministerial Decision is a binding interpretation as per Article IX:2 of the *WTO Agreement*", and that it may also be considered a subsequent agreement between the parties, within the meaning of Article 31(3)(a) of the *Vienna Convention*, on the interpretation of the term "reasonable interval" in Article 2.12 of the *TBT Agreement*.<sup>455</sup>

244. In paragraph 7.575 of its Report, the Panel stated that the wording of paragraph 5.2 of the Doha Ministerial Decision "*appears to suggest* that the intention of the Ministerial Conference, and thus the highest level organ of the WTO where all Members meet, was that paragraph 5.2 is

<sup>450</sup>Panel Report, para. 7.576.

<sup>451</sup>Panel Report, para. 7.576.

<sup>452</sup>United States' appellant's submission, para. 124 (referring to Panel Report, para. 7.576).

<sup>453</sup>United States' appellant's submission, para. 129.

<sup>454</sup>United States' appellant's submission, para. 126.

<sup>455</sup>Indonesia's appellee's submission, para. 222. (original emphasis)

binding".<sup>456</sup> On appeal, Indonesia relies on this latter statement made by the Panel and argues that the Panel found that paragraph 5.2 of the Doha Ministerial Decision is a binding interpretation "as per" Article IX:2 of the *WTO Agreement*.<sup>457</sup>

245. In paragraph 7.576 of its Report, the Panel stated that, although the United States and Indonesia disagreed on the categorization of paragraph 5.2 of the Doha Ministerial Decision as an authoritative interpretation under Article IX:2 of the *WTO Agreement*, it would be "guided by [paragraph 5.2] in its interpretation of the phrase 'reasonable interval', as it was agreed by all WTO Members meeting in the form of Ministerial Conference, the highest ranking body of the WTO". On appeal, the United States relies on this statement of the Panel and argues that the Panel did not find that paragraph 5.2 constitutes an authoritative interpretation adopted by the Ministerial Conference pursuant to Article IX:2 of the *WTO Agreement*.<sup>458</sup>

246. As we see it, in paragraph 7.575 of its Report, the Panel identified certain features of the Doha Ministerial Decision that *suggest* that Members intended to adopt a "binding" interpretation of the term "reasonable interval" in Article 2.12 of the *TBT Agreement*. The Panel's statement in paragraph 7.575 was, by its own terms, tentative. Moreover, the Panel's statement was not followed by any "finding" that paragraph 5.2 constitutes an interpretation adopted pursuant to Article IX:2 of the *WTO Agreement*. Thus, we do not agree with Indonesia that the Panel *found* that paragraph 5.2 of the Doha Ministerial Decision "is a binding interpretation as per Article IX:2 of the *WTO Agreement*".<sup>459</sup>

247. Despite our conclusion that the Panel did not formally determine whether paragraph 5.2 of the Doha Ministerial Decision constitutes a multilateral interpretation under Article IX:2 of the *WTO Agreement*, we will consider, nevertheless, whether paragraph 5.2, in fact, has that legal status. Before doing so, we set forth some general considerations on the role and function of multilateral interpretations adopted pursuant to Article IX:2 of the *WTO Agreement*.

<sup>456</sup>Emphasis added.

<sup>457</sup>Indonesia's appellee's submission, para. 222.

<sup>458</sup>United States' appellant's submission, para. 124.

<sup>459</sup>Indonesia's appellee's submission, para. 222.

248. Article IX:2 of the *WTO Agreement* provides:

The Ministerial Conference and the General Council shall have the exclusive authority to adopt interpretations of this Agreement and of the Multilateral Trade Agreements. In the case of an interpretation of a Multilateral Trade Agreement in Annex I, they shall exercise their authority on the basis of a recommendation by the Council overseeing the functioning of that Agreement. The decision to adopt an interpretation shall be taken by a three-fourths majority of the Members. This paragraph shall not be used in a manner that would undermine the amendment provisions in Article X.

249. In *EC – Bananas III (Article 21.5 – Ecuador II) / EC – Bananas III (Article 21.5 – US)*, the Appellate Body opined that multilateral interpretations adopted pursuant to Article IX:2 of the *WTO Agreement* are "meant to clarify the meaning of existing obligations, not to modify their content".<sup>460</sup> Article IX:2 establishes that a decision to adopt a multilateral interpretation can only be taken by Members sitting in the form of the Ministerial Conference or the General Council, and that such decisions must be taken by a three-fourths majority of Members. With regard to decisions adopting multilateral interpretations of a Multilateral Trade Agreement contained in Annex I to the *WTO Agreement*, Article IX:2 requires the Ministerial Conference or the General Council to exercise its authority on the basis of a recommendation by the Council overseeing the functioning of that Agreement. Thus, while Article IX:2 confers upon the Ministerial Conference and the General Council the exclusive authority to adopt multilateral interpretations of the *WTO Agreement*, the exercise of this authority is situated within defined parameters established by Article IX:2.

250. Multilateral interpretations adopted pursuant to Article IX:2 of the *WTO Agreement* have a pervasive legal effect. Such interpretations are binding on all Members. As we see it, the broad legal effect of these interpretations is precisely the reason why Article IX:2 subjects the adoption of such interpretations to clearly articulated and strict decision-making procedures.

251. Turning to the question of whether paragraph 5.2 of the Doha Ministerial Decision can be characterized as a multilateral interpretation of Article 2.12 of the *TBT Agreement*, we recall that Article IX:2 of the *WTO Agreement* establishes two specific requirements that apply to the adoption of multilateral interpretations of the Multilateral Trade Agreements contained in Annex I to the *WTO Agreement*: (i) a decision by the Ministerial Conference or the General Council to adopt such interpretations shall be taken by a three-fourths majority of Members; and (ii) such interpretations shall be taken on the basis of a recommendation by the Council overseeing the functioning of the

relevant Agreement. Thus, we will consider whether the decision to adopt paragraph 5.2 conforms with these specific decision-making procedures.

252. With regard to the first requirement, the Panel observed that the Ministerial Conference decided on the matters addressed in the Doha Ministerial Decision *by consensus*. The issue of whether the first requirement was met has not been raised in this appeal. With regard to the second requirement, the Panel noted that, "it appears that when adopting the Doha Ministerial Decision, the Ministerial Conference did not comply with the preliminary requirement under Article IX:2 of the *WTO Agreement*" to exercise its authority on the basis of a recommendation from the Council for Trade in Goods.<sup>461</sup> The Panel stated, further, that "it could be argued" that the absence of this "formal requirement" is insufficient to conclude that paragraph 5.2 of the Doha Ministerial Decision is not an authoritative interpretation under Article IX:2 of the *WTO Agreement*.<sup>462</sup> On appeal, the United States argues that "[a] panel is not authorized to waive the requirements of Article IX:2 or to impose on Members an interpretation that is not adopted in the manner required."<sup>463</sup>

253. We do not agree with the Panel to the extent that it suggested that the absence of a recommendation from the Council for Trade in Goods "is insufficient to conclude that paragraph 5.2 of the Doha Ministerial Decision is not an authoritative interpretation under Article IX:2 of the *WTO Agreement*".<sup>464</sup> While Article IX:2 of the *WTO Agreement* confers upon the Ministerial Conference and the General Council the exclusive authority to adopt multilateral interpretations of the *WTO Agreement*, this authority must be exercised within the defined parameters of Article IX:2. It seems to us that the view expressed by the Panel does not respect a specific decision-making procedure established by Article IX:2 of the *WTO Agreement*. In our view, to characterize the requirement to act on the basis of a recommendation by the Council overseeing the functioning of the relevant Agreement as a "formal requirement" neither permits a panel to read that requirement out of a treaty provision, nor to dilute its effectiveness.

254. Although the Panel's reasoning may be read as suggesting that the Ministerial Conference could dispense with a specific requirement established by Article IX:2 of the *WTO Agreement*, the terms of Article IX:2 do not suggest that compliance with this requirement is dispensable. In this connection, we recall that, pursuant to Article IX:2 of the *WTO Agreement*, the Ministerial Conference or the General Council "shall" exercise their authority to adopt an interpretation of a

<sup>461</sup>Panel Report, para. 7.574 (referring to United States' response to Panel Question 6, para. 5). (emphasis added)

<sup>462</sup>Panel Report, para. 7.575.

<sup>463</sup>United States' appellant's submission, para. 125.

<sup>464</sup>Panel Report, para. 7.575.

<sup>460</sup>Appellate Body Reports, *EC – Bananas III (Article 21.5 – Ecuador II) / EC – Bananas III (Article 21.5 – US)*, para. 383.

Multilateral Trade Agreement contained in Annex 1 to the *WTO Agreement* "on the basis of a recommendation" by the Council overseeing the functioning of that Agreement. We consider that the recommendation from the relevant Council is an essential element of Article IX:2, which constitutes the legal basis upon which the Ministerial Conference or the General Council exercise their authority to adopt interpretations of the *WTO Agreement*. Thus, an interpretation of a Multilateral Trade Agreement contained in Annex 1 to the *WTO Agreement* must be adopted on the basis of a recommendation from the relevant Council overseeing the functioning of that Agreement.

255. We note that, before the Panel, Indonesia relied on paragraph 12 of the Doha Ministerial Declaration<sup>465</sup> and on the preamble of the Doha Ministerial Decision, and argued that the interpretation of Article 2.12 of the *TBT Agreement* was reached on the basis of discussions carried out within the General Council and the WTO subsidiary bodies.<sup>466</sup> Whereas the content of paragraph 5.2 of the Doha Ministerial Decision might very well have been based on discussions within the Committee on Technical Barriers to Trade, we are not persuaded that this is sufficient to establish that the Ministerial Conference exercised its authority to adopt an interpretation of the *TBT Agreement* on the basis of a recommendation from the Council for Trade in Goods. Accordingly, we find that, in the absence of evidence of the existence of a specific recommendation from the Council for Trade in Goods concerning the interpretation of Article 2.12 of the *TBT Agreement*, paragraph 5.2 of the Doha Ministerial Decision does not constitute a multilateral interpretation adopted pursuant to Article IX:2 of the *WTO Agreement*.<sup>467</sup>

256. In the light of our finding that paragraph 5.2 of the Doha Ministerial Decision does not qualify as a multilateral interpretation within the meaning of Article IX:2 of the *WTO Agreement*, we address whether, as the Panel found, paragraph 5.2 "could be considered as a subsequent agreement of the parties within the meaning of Article 31(3)(a) of the [*Vienna Convention*], on the interpretation of 'reasonable interval' [in] Article 2.12 of the *TBT Agreement*".<sup>468</sup>

257. We note that, in response to questioning at the oral hearing, the United States argued that a decision by the Ministerial Conference that does not conform with the specific decision-making procedures established by Article IX:2 of the *WTO Agreement* cannot constitute a "subsequent agreement between the parties" within the meaning of Article 31(3)(a) of the *Vienna Convention*. We

<sup>465</sup> Adopted on 14 November 2001, WT/MIN(01)/DEC/1.

<sup>466</sup> Panel Report, para. 7.574 (referring to Indonesia's response to Panel Question 6, para. 27).

<sup>467</sup> In reaching this finding, we are not saying that the Ministerial Conference failed to comply with a specific decision-making procedure established by Article IX:2 of the *WTO Agreement*. Rather, we are saying that the absence of a recommendation from the Council for Trade in Goods concerning the interpretation of Article 2.12 of the *TBT Agreement* supports a conclusion that paragraph 5.2 of the Doha Ministerial Decision does not constitute a multilateral interpretation adopted pursuant to Article IX:2 of the *WTO Agreement*.

<sup>468</sup> Panel Report, para. 7.576. (footnote omitted)

observe that multilateral interpretations adopted pursuant to Article IX:2 of the *WTO Agreement*, on the one hand, and subsequent agreements on interpretation within the meaning of Article 31(3)(a) of the *Vienna Convention*, on the other hand, serve different functions and have different legal effects under WTO law. Multilateral interpretations under Article IX:2 of the *WTO Agreement* provide a means by which Members—acting through the highest organs of the WTO—may adopt binding interpretations that clarify WTO law for all Members. Such interpretations are binding on all Members, including in respect of all disputes in which these interpretations are relevant.

258. On the other hand, Article 31(3)(a) of the *Vienna Convention* is a rule of treaty interpretation, pursuant to which a treaty interpreter uses a subsequent agreement between the parties on the interpretation of a treaty provision as an interpretative tool to determine the meaning of that treaty provision. Pursuant to Article 3.2 of the DSU, panels and the Appellate Body are required to apply the customary rules of interpretation of public international law—including the rule embodied in Article 31(3)(a) of the *Vienna Convention*—to clarify the existing provisions of the covered agreements. Interpretations developed by panels and the Appellate Body in the course of dispute settlement proceedings are binding only on the parties to a particular dispute.<sup>469</sup> Article IX:2 of the *WTO Agreement* does not preclude panels and the Appellate Body from having recourse to a customary rule of interpretation of public international law that, pursuant to Article 3.2 of the DSU, they are required to apply.

259. We also recall that, in *EC – Bananas III (Article 21.5 – Ecuador II) / EC – Bananas III (Article 21.5 – US)*, the Appellate Body stated that "multilateral interpretations are meant to clarify the meaning of existing obligations"<sup>470</sup>, and that "multilateral interpretations adopted pursuant to Article IX:2 of the *WTO Agreement* are *most akin* to subsequent agreements within the meaning of Article 31(3)(a) of the *Vienna Convention*".<sup>471</sup> Thus, given the specific function of multilateral

<sup>469</sup> In *US – Stainless Steel (Mexico)*, the Appellate Body stated:

It is well settled that Appellate Body reports are not binding, except with respect to resolving the particular dispute between the parties. This, however, does not mean that subsequent panels are free to disregard the legal interpretations and the *ratio decidendi* contained in previous Appellate Body reports that have been adopted by the DSB.

... Thus, the legal interpretation embodied in adopted panel and Appellate Body reports becomes part and parcel of the *acquis* of the WTO dispute settlement system. Ensuring "security and predictability" in the dispute settlement system, as contemplated in Article 3.2 of the DSU, implies that, absent cogent reasons, an adjudicatory body will resolve the same legal question in the same way in a subsequent case.

(Appellate Body Report, *US – Stainless Steel (Mexico)*, paras. 158 and 160 (footnotes omitted))  
<sup>470</sup> Appellate Body Reports, *EC – Bananas III (Article 21.5 – Ecuador II) / EC – Bananas III (Article 21.5 – US)*, para. 383.

<sup>471</sup> Appellate Body Reports, *EC – Bananas III (Article 21.5 – Ecuador II) / EC – Bananas III (Article 21.5 – US)*, para. 390. (emphasis added)

interpretations adopted pursuant to Article IX:2, and the fact that these interpretations are adopted by Members sitting in the form of the highest organs of the WTO, such interpretations are most akin to, but *not exhaustive of*, subsequent agreements on interpretation within the meaning of Article 31(3)(a) of the *Vienna Convention*.

260. We consider, therefore, that a decision adopted by Members, *other than* a decision adopted pursuant to Article IX:2 of the *WTO Agreement*, may constitute a "subsequent agreement" on the interpretation of a provision of a covered agreement under Article 31(3)(a) of the *Vienna Convention*. Accordingly, we turn to the issue of whether paragraph 5.2 of the Doha Ministerial Decision can be considered to be a subsequent agreement, within the meaning of Article 31(3)(a) of the *Vienna Convention*, on the interpretation of the term "reasonable interval" in Article 2.12 of the *TBT Agreement*.

261. Article 31(3)(a) of the *Vienna Convention* provides:

There shall be taken into account, together with the context:

- (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions[.]

262. Based on the text of Article 31(3)(a) of the *Vienna Convention*, we consider that a decision adopted by Members may qualify as a "subsequent agreement between the parties" regarding the interpretation of a covered agreement or the application of its provisions if: (i) the decision is, in a temporal sense, adopted subsequent to the relevant covered agreement; and (ii) the terms and content of the decision express an *agreement* between Members on the *interpretation* or *application* of a provision of WTO law.

263. With regard to the first element, we note that the Doha Ministerial Decision was adopted by consensus on 14 November 2001 on the occasion of the Fourth Ministerial Conference of the WTO. Thus, it is beyond dispute that paragraph 5.2 of the Doha Ministerial Decision was adopted subsequent to the relevant WTO agreement at issue, the *TBT Agreement*. With regard to the second element, the key question to be answered is whether paragraph 5.2 of the Doha Ministerial Decision expresses an *agreement* between Members on the *interpretation* or *application* of the term "reasonable interval" in Article 2.12 of the *TBT Agreement*.

264. We recall that paragraph 5.2 of the Doha Ministerial Decision provides:

Subject to the conditions specified in paragraph 12 of Article 2 of the Agreement on Technical Barriers to Trade, the phrase "reasonable interval" shall be understood to mean normally a period of not less

than 6 months, except when this would be ineffective in fulfilling the legitimate objectives pursued.

265. In addressing the question of whether paragraph 5.2 of the Doha Ministerial Decision expresses an agreement between Members on the interpretation or application of the term "reasonable interval" in Article 2.12 of the *TBT Agreement*, we find useful guidance in the Appellate Body reports in *EC – Bananas III (Article 21.5 – Ecuador II) / EC – Bananas III (Article 21.5 – US)*. The Appellate Body observed that the International Law Commission (the "ILC") describes a subsequent agreement within the meaning of Article 31(3)(a) of the *Vienna Convention* as "a further *authentic element of interpretation* to be taken into account together with the context". According to the Appellate Body, "by referring to 'authentic interpretation', the ILC reads Article 31(3)(a) as referring to *agreements bearing specifically upon the interpretation of the treaty*."<sup>472</sup> Thus, we will consider whether paragraph 5.2 bears specifically upon the interpretation of Article 2.12 of the *TBT Agreement*.

266. Paragraph 5.2 of the Doha Ministerial Decision refers explicitly to the term "reasonable interval" in Article 2.12 of the *TBT Agreement* and defines this interval as "normally a period of not less than 6 months, except when this would be ineffective in fulfilling the legitimate objectives pursued" by a technical regulation. In the light of the terms and content of paragraph 5.2, we are unable to discern a function of paragraph 5.2 *other than* to interpret the term "reasonable interval" in Article 2.12 of the *TBT Agreement*. We consider, therefore, that paragraph 5.2 *bears specifically* upon the interpretation of the term "reasonable interval" in Article 2.12 of the *TBT Agreement*. We turn now to consider whether paragraph 5.2 of the Doha Ministerial Decision reflects an "agreement" among Members—within the meaning of Article 31(3)(a) of the *Vienna Convention*—on the interpretation of the term "reasonable interval" in Article 2.12 of the *TBT Agreement*.

267. We note that the text of Article 31(3)(a) of the *Vienna Convention* does not establish a requirement as to the form which a "subsequent agreement between the parties" should take. We consider, therefore, that the term "agreement" in Article 31(3)(a) of the *Vienna Convention* refers, fundamentally, to substance rather than to form. Thus, in our view, paragraph 5.2 of the Doha Ministerial Decision can be characterized as a "subsequent agreement" within the meaning of Article 31(3)(a) of the *Vienna Convention* provided that it clearly expresses a common understanding, and an acceptance of that understanding among Members with regard to the meaning of the term "reasonable interval" in Article 2.12 of the *TBT Agreement*. In determining whether this is so, we find the terms and content of paragraph 5.2 to be dispositive. In this connection, we note that the understanding among Members with regard to the meaning of the term "reasonable interval" in

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<sup>472</sup>Appellate Body Reports, *EC – Bananas III (Article 21.5 – Ecuador II) / EC – Bananas III (Article 21.5 – US)*, para. 390. (emphasis added)

Article 2.12 of the *TBT Agreement* is expressed by terms—"shall be understood to mean"—that cannot be considered as merely hortatory.

268. For the foregoing reasons, we uphold the Panel's finding, in paragraph 7.576 of the Panel Report, that paragraph 5.2 of the Doha Ministerial Decision constitutes a subsequent agreement between the parties, within the meaning of Article 31(3)(a) of the *Vienna Convention*, on the interpretation of the term "reasonable interval" in Article 2.12 of the *TBT Agreement*.

269. In the light of our characterization of paragraph 5.2 of the Doha Ministerial Decision as a subsequent agreement between the parties within the meaning of Article 31(3)(a) of the *Vienna Convention*, we turn now to consider the meaning of Article 2.12 of the *TBT Agreement* in the light of the clarification of the term "reasonable interval" provided by paragraph 5.2. We observe that, in its commentaries on the *Draft articles on the Law of Treaties*, the ILC states that a subsequent agreement between the parties within the meaning of Article 31(3)(a) "must be read into the treaty for purposes of its interpretation".<sup>473</sup> As we see it, while the terms of paragraph 5.2 must be "read into" Article 2.12 for the purpose of interpreting that provision, this does not mean that the terms of paragraph 5.2 replace or override the terms contained in Article 2.12. Rather, the terms of paragraph 5.2 of the Doha Ministerial Decision constitute an interpretative clarification to be taken into account in the interpretation of Article 2.12 of the *TBT Agreement*.

270. Article 2.12 of the *TBT Agreement* provides:

Except in those urgent circumstances referred to in paragraph 10, Members shall allow a reasonable interval between the publication of technical regulations and their entry into force in order to allow time for producers in exporting Members, and particularly in developing country Members, to adapt their products or methods of production to the requirements of the importing Member.

271. Paragraph 5.2 of the Doha Ministerial Decision provides:

Subject to the conditions specified in paragraph 12 of Article 2 of the Agreement on Technical Barriers to Trade, the phrase 'reasonable interval' shall be understood to mean normally a period of not less than 6 months, except when this would be ineffective in fulfilling the legitimate objectives pursued.

272. We note, as did the Panel, that Article 2.12 of the *TBT Agreement* explains that "the reason for allowing an interval between the publication and the entry into force of a technical regulation is to allow time for producers in exporting Members, and particularly in developing country Members, to adapt their products or methods of production" to the requirements of the importing Members' technical regulation.<sup>474</sup> In our view, the term "normally" in paragraph 5.2 relates to the rationale of the obligation articulated in Article 2.12 of the *TBT Agreement*. Seen in this light, the term "normally" provides the interpretative link between Article 2.12, on the one hand, and paragraph 5.2, on the other hand. Thus, we consider that, taking into account the interpretative clarification provided by paragraph 5.2 of the Doha Ministerial Decision, Article 2.12 of the *TBT Agreement* establishes a rule that "normally" producers in exporting Members require a period of "not less than 6 months" to adapt their products or production methods to the requirements of an importing Member's technical regulation.

273. On appeal, the United States argues that the use of the term "normally" in paragraph 5.2 of the Doha Ministerial Decision does not support the conclusion that paragraph 5.2 represents a rule.<sup>475</sup> We observe that the ordinary meaning of the term "normally" is defined as "under normal or ordinary conditions; as a rule".<sup>476</sup> In our view, the qualification of an obligation with the adverb "normally" does not, necessarily, alter the characterization of that obligation as constituting a "rule". Rather, we consider that the use of the term "normally" in paragraph 5.2 indicates that the rule establishing that foreign producers require a minimum of "not less than 6 months" to adapt to the requirements of a technical regulation admits of derogation under certain circumstances.

274. The obligation imposed on Members by Article 2.12 to provide a "reasonable interval" between the publication and the entry into force of their technical regulations carefully balances the interests of, on the one hand, the exporting Member whose producers might be affected by a technical regulation and, on the other hand, the importing Member that wishes to pursue a legitimate objective through a technical regulation. With regard to the former, Article 2.12 of the *TBT Agreement*, as clarified by paragraph 5.2 of the Doha Ministerial Decision, establishes a rule that, "normally", producers in exporting Members require a period of at least six months to adapt their products or production methods to the requirements of the importing Member's technical regulation. Thus, Article 2.12 presumes that foreign producers in exporting Members, and particularly in developing country Members, require a minimum of at least six months to adapt to the requirements of an importing Member's technical regulation.

<sup>474</sup>Panel Report, para. 7.582.

<sup>475</sup>United States' appellant's submission, para. 127.

<sup>476</sup>*Shorter Oxford English Dictionary*, 6th edn, A. Stevenson (ed.) (Oxford University Press, 2007), Vol. 2, p. 1945.

<sup>473</sup>*Draft articles on the Law of Treaties with commentaries*. Text adopted by the ILC at its eighteenth session, in 1966, and submitted to the United Nations General Assembly as a part of the Commission's report covering the work of that session (at para. 38). The ILC report, which also contains commentaries on the draft articles, appears in the *Yearbook of the International Law Commission, 1966*, Vol. II, p. 221, para. 14.

275. With regard to the interests of the importing Member, we recall that paragraph 5.2 of the Doha Ministerial Decision tempers the obligation to provide a "reasonable interval" of not less than six months between the publication and the entry into force of a technical regulation by stipulating that this obligation applies "except when this would be ineffective in fulfilling the legitimate objectives pursued" by the technical regulation. Thus, while Article 2.12 of the *TBT Agreement* imposes an obligation on importing Members to provide a "reasonable interval" of not less than six months between the publication and entry into force of a technical regulation, an importing Member may depart from this obligation if this interval "would be ineffective to fulfil the legitimate objectives pursued" by the technical regulation.

C. *The Panel's Finding that the United States Acted Inconsistently with Article 2.12 of the TBT Agreement*

276. We turn now to consider the United States' claim that the Panel erred in finding that Indonesia had established a *prima facie* case of inconsistency with Article 2.12 of the *TBT Agreement* that the United States failed to rebut. The United States advances, essentially, two arguments in support of its claim that the Panel incorrectly found that Indonesia had established a *prima facie* case of inconsistency with Article 2.12 of the *TBT Agreement*. First, the United States argues that the Panel erred in finding that Indonesia had established a *prima facie* case because Indonesia did not establish that the three-month interval between the publication and entry into force of Section 907(a)(1)(A) of the FFDCAs was unreasonable in the light of its impact on the ability of Indonesian producers to adapt to the requirements of that measure.<sup>477</sup> Second, the United States argues that, even assuming *arguendo* that the Panel was correct in deciding that the elements of a *prima facie* case may be drawn exclusively from paragraph 5.2 of the Doha Ministerial Decision, the Panel erred in finding that Indonesia had "succeeded in making such a case".<sup>478</sup>

277. According to the United States, in view of the elements contained in paragraph 5.2 of the Doha Ministerial Decision, Indonesia "would have to establish with evidence and argument" a *prima facie* case that: (i) "urgent circumstances" did not exist; (ii) the interval period was less than six months; (iii) "this is a 'normal' situation"; and (iv) allowing an interval of at least six months would not render the fulfilment of the objective pursued by Section 907(a)(1)(A) ineffective.<sup>479</sup> Indonesia, in response, argues that it did establish "a *prima facie* case that the 90-day interval provided by the United States was significantly shorter than the 6 months" normally required.<sup>480</sup>

<sup>477</sup>United States' appellant's submission, paras. 132-134.

<sup>478</sup>United States' appellant's submission, para. 135.

<sup>479</sup>United States' appellant's submission, para. 136.

<sup>480</sup>Indonesia's appellee's submission, para. 237.

278. The United States and Indonesia do not agree on the elements of a *prima facie* case that a complaining Member is required to establish under Article 2.12 of the *TBT Agreement*. Moreover, it appears that the divergence stems from the fact that the United States and Indonesia attribute a different interpretative value to paragraph 5.2 of the Doha Ministerial Decision. In this connection, we note that the United States argues that the elements of a *prima facie* case of inconsistency with Article 2.12 are to be drawn from the text of Article 2.12, but that, "[e]ven assuming *arguendo* that the Panel" could draw the elements of a *prima facie* case from paragraph 5.2, the Panel erred in finding that Indonesia had made such a case.<sup>481</sup>

279. We do not consider that the elements of a *prima facie* case of inconsistency with Article 2.12 of the *TBT Agreement* are to be drawn exclusively from either the terms of Article 2.12, on the one hand, or of paragraph 5.2 of the Doha Ministerial Decision, on the other hand. Article 2.12 imposes an obligation on importing Members to allow a "reasonable interval" between the publication and the entry into force of their technical regulations. We recall our finding above that paragraph 5.2 of the Doha Ministerial Decision constitutes a subsequent agreement between the parties, within the meaning of Article 31(3)(a) of the *Vienna Convention*, on the interpretation of the term "reasonable interval" in Article 2.12 of the *TBT Agreement*. Thus, it seems to us that the elements of a *prima facie* case of inconsistency with Article 2.12 of the *TBT Agreement* are to be drawn from a proper interpretation of Article 2.12, taking into account—pursuant to Article 31(3)(a) of the *Vienna Convention*—the interpretative clarification provided by the terms of paragraph 5.2 of the Doha Ministerial Decision.

280. We further recall our finding above that Article 2.12 of the *TBT Agreement*, properly interpreted in the light of paragraph 5.2 of the Doha Ministerial Decision, establishes a rule that, "normally", producers in exporting Members require a period of at least six months to adapt their products or production methods to the requirements of the importing Member's technical regulation. Based on our interpretation of Article 2.12 of the *TBT Agreement*, we consider that a *prima facie* case of inconsistency with Article 2.12 is established where it is shown that an importing Member has failed to allow an interval of not less than six months between the publication and the entry into force of the technical regulation at issue.

281. In accordance with the general rules on burden of proof reflected in *US – Wool Shirts and Blouses*, we consider that, under Article 2.12 of the *TBT Agreement*, it is for the complaining Member to establish that the responding Member has not allowed an interval of not less than six months

<sup>481</sup>United States' appellant's submission, para. 135.

between the publication and the entry into force of the technical regulation at issue.<sup>482</sup> If the complaining Member establishes this *prima facie* case of inconsistency, it is for the responding Member to rebut the *prima facie* case of inconsistency with Article 2.12. We recall that, in *US – Wool Shirts and Blouses*, the Appellate Body stated that "precisely how much and precisely what kind of evidence" will be required to establish a *prima facie* case "will necessarily vary from measure to measure, provision to provision, and case to case".<sup>483</sup> We consider that, similarly, this reasoning applies with regard to the quantity and nature of evidence required to rebut a *prima facie* case of inconsistency.

282. The text of Article 2.12 of the *TBT Agreement* read in the light of paragraph 5.2 of the Doha Ministerial Decision provides an indication of the nature of evidence that is required to rebut a *prima facie* case of inconsistency with that provision. First, Article 2.12 of the *TBT Agreement* excludes from the obligation to provide a "reasonable interval" between the publication and the entry into force of technical regulations "those urgent circumstances" referred to in Article 2.10 of the *TBT Agreement*. Thus, where "urgent problems of safety, health, environmental protection or national security" arise for a Member that is implementing a technical regulation, a period of six months or more cannot be considered to be a "reasonable interval" within the meaning of Article 2.12. Second, Article 2.12 expressly states that the rationale for providing a "reasonable interval" between the publication and the entry into force of a technical regulation is "to allow time for producers in exporting Members, and particularly in developing country Members, to adapt their products or methods of production" to the requirements of the importing Member's technical regulation. If these producers can adapt their products or production methods to the requirements of an importing Member's technical regulation in less than six months, a period of six months or more cannot be considered to be a "reasonable interval" within the meaning of Article 2.12. Third, paragraph 5.2 allows an importing Member to depart from the obligation to provide a "reasonable interval" of, "normally", not less than six months between the publication and entry into force of their technical regulation, if this interval would be "ineffective to fulfil the legitimate objectives pursued" by its technical regulation. Therefore, a period of "not less than six months" cannot be considered to be a "reasonable interval", within the meaning of Article 2.12, if this period would be ineffective to fulfil the legitimate objectives pursued by the technical regulation at issue.

<sup>482</sup>In *US – Wool Shirts and Blouses*, the Appellate Body outlined the general rules on burden of proof by stating that:

... the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence. If that party adduces evidence sufficient to raise a presumption that what is claimed is true, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption.

(Appellate Body Report, *US – Wool Shirts and Blouses*, p. 14, DSR 1997:1, 323, at 335)  
<sup>483</sup>Appellate Body Report, *US – Wool Shirts and Blouses*, p. 14, DSR 1997:1, 323, at 335.

283. Thus, in the light of the above, we consider that, in order to rebut a *prima facie* case of inconsistency with Article 2.12 of the *TBT Agreement*, a responding Member that has allowed an interval of less than six months between the publication and entry into force of its technical regulation must submit evidence and argument sufficient to establish *either*: (i) that the "urgent circumstances" referred to in Article 2.10 of the *TBT Agreement* surrounded the adoption of the technical regulation at issue; (ii) that producers of the complaining Member could have adapted to the requirements of the technical regulation at issue within the shorter interval that it allowed; *or* (iii) that a period of "not less than" six months would be ineffective to fulfil the legitimate objectives of its technical regulation.

284. The Panel found that Indonesia had made a *prima facie* case that "allowing at least six months between the date of publication of Section 907(a)(1)(A) and its entry into force would not render the fulfilment of the objective pursued by Section 907(a)(1)(A) ineffective."<sup>484</sup> Thus, in the Panel's view, the burden was on Indonesia to establish a *prima facie* case of inconsistency with Article 2.12 of the *TBT Agreement* that included establishing that a period of at least six months between the publication of Section 907(a)(1)(A) and its entry into force would not render the fulfilment of the objective pursued by Section 907(a)(1)(A) ineffective. The United States argues that Indonesia failed to establish such a *prima facie* case. Relying on the Appellate Body's ruling on the burden of proof under Article 2.4 of the *TBT Agreement* in *EC – Sardines*, the United States argues on appeal that the burden rests with the complaining Member to adduce sufficient evidence and argument to establish that an interval of not less than six months would be effective in fulfilling the objectives of the technical regulation at issue.<sup>485</sup>

285. In *EC – Sardines*, the Appellate Body was considering the allocation of the burden of proof in the context of a claim of inconsistency with Article 2.4 of the *TBT Agreement*. As we see it, the fact that two provisions manifest a degree of structural similarity does not, *necessarily*, support a conclusion that the allocation of the burden of proof in respect of each provision must be identical.<sup>486</sup>

286. We recall our view expressed above that the elements of a *prima facie* case of inconsistency with Article 2.12 of the *TBT Agreement* are to be drawn from a proper interpretation of Article 2.12, taking into account—pursuant to Article 31(3)(a) of the *Vienna Convention*—the interpretative clarification provided by the terms of paragraph 5.2 of the Doha Ministerial Decision. In much the

<sup>484</sup>Panel Report, para. 7.592.

<sup>485</sup>United States' appellant's submission, para. 143 (referring to Appellate Body Report, *EC – Sardines*, para. 288).

<sup>486</sup>We are not saying that the fact that the burden of proof is allocated in a particular manner with respect to a particular provision of the covered agreements is not a relevant consideration in discerning how the burden of proof is allocated under a similar provision of the covered agreements. Rather, we are saying that the conceptual or structural similarity between two provisions does not, by itself, necessitate a conclusion that the burden of proof in respect of both provisions must be allocated in an identical manner.

same way, the manner in which the burden of proof is allocated under Article 2.12 of the *TBT Agreement* must be informed by an interpretation that properly canvasses the text, context, and object and purpose of Article 2.12. In our view, the burden of proof in respect of a particular provision of the covered agreements *cannot* be understood in isolation from the overarching logic of that provision, and the function which it is designed to serve. On the contrary, it is by having regard for the function and rationale of a particular provision that an adjudicator can, adequately, assess the manner in which the burden of proof should be allocated under that provision.

287. We recall that Article 2.12 of the *TBT Agreement* explains that the reason for allowing an interval between the publication and the entry into force of a technical regulation is "to allow time for producers in exporting Members, and particularly in developing country Members, to adapt their products or methods of production" to the requirements of the importing Member's technical regulation. By its own terms, Article 2.12 singles out producers in exporting Members, and particularly in developing country Members, as the beneficiaries of a "reasonable interval" between the publication and the entry into force of an importing Member's technical regulation. Thus, the concept of a "reasonable interval" within the meaning of Article 2.12 is meant to provide a degree of certainty to producers in exporting Members, and particularly in developing country Members, with regard to the time within which an importing Member's technical regulation can reasonably be expected to enter into force.

288. Paragraph 5.2 of the Doha Ministerial Decision provides interpretative clarification of the concept of a "reasonable interval" within the meaning of Article 2.12 by establishing a rule that producers in exporting Members require a period of at least six months to adapt their products or production methods to the requirements of the importing Member's technical regulation. Thus, paragraph 5.2 enhances the degree of certainty that the concept of a "reasonable interval" is meant to provide to producers in exporting Members, and particularly in developing country Members, with regard to the time within which an importing Member's technical regulation can reasonably be expected to enter into force.

289. The rule in Article 2.12, as clarified by paragraph 5.2 of the Doha Ministerial Decision, is expressly designed to allow producers in the complaining Member, and in particular in a complaining developing country Member, sufficient time to adapt their products or production methods to the requirements of the responding Member's technical regulation. Thus, it seems to us that, where a responding Member seeks to deviate from this rule, which, by its own terms, singles out producers in the complaining Member as the beneficiaries of a "reasonable interval" between the publication and the entry into force of a technical regulation, the responding Member must shoulder the burden of establishing a *prima facie* case that the conditions under which derogations from the rule are

permitted are extant. Thus, we disagree with the Panel that it was for Indonesia to establish a *prima facie* case that a period of at least six months between the publication of Section 907(a)(1)(A) and its entry into force would not render the fulfilment of the objective pursued by Section 907(a)(1)(A) ineffective. Instead, we consider that, under Article 2.12 of the *TBT Agreement*, as clarified by paragraph 5.2 of the Doha Ministerial Decision, the burden rests upon the responding Member to make a *prima facie* case that an interval of not less than six months "would be ineffective to fulfil the legitimate objectives pursued" by its technical regulation.

290. In sum, under Article 2.12 of the *TBT Agreement*, as clarified by paragraph 5.2 of the Doha Ministerial Decision, a complaining Member is required to establish a *prima facie* case that the responding Member has failed to allow for a period of at least six months between the publication and the entry into force of the technical regulation at issue. If the complaining Member establishes such a *prima facie* case, the burden rests on the responding Member that has allowed for an interval of less than six months between the publication and the entry into force of its technical regulation to establish *either*: (i) that the "urgent circumstances" referred to in Article 2.10 of the *TBT Agreement* surrounded the adoption of the technical regulation at issue; (ii) that producers of the complaining Member could have adapted to the requirements of the technical regulation at issue within the shorter interval that it allowed; *or* (iii) that a period of "not less than" six months would be ineffective to fulfil the legitimate objectives of its technical regulation.

291. In order to establish a *prima facie* case of inconsistency with Article 2.12 of the *TBT Agreement*, Indonesia was required to establish that the United States did not allow an interval of at least six months between the publication and the entry into force of the technical regulation at issue. In this connection, we note the Panel's finding that the actual interval allowed by the United States between the publication and the entry into force of Section 907(a)(1)(A) was a "90-day period or a three-month period".<sup>487</sup> Thus, we agree with the Panel that Indonesia established a *prima facie* case of inconsistency with Article 2.12 of the *TBT Agreement*.

292. In order to rebut the *prima facie* case of inconsistency with Article 2.12 of the *TBT Agreement* made by Indonesia, the United States was required to submit evidence and argument sufficient to establish *either*: (i) that the "urgent circumstances" referred to in Article 2.10 of the *TBT Agreement* surrounded the adoption of Section 907(a)(1)(A); (ii) that producers in Indonesia could have adapted to the requirements of Section 907(a)(1)(A) within a three-month interval; *or* (iii) that a period of "not less than" six months would be ineffective to fulfil the legitimate objectives of Section 907(a)(1)(A).

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<sup>487</sup>Panel Report, para. 7.567.

293. With regard to whether the "urgent circumstances" referred to in Article 2.10 of the *TBT Agreement* surrounded the adoption of Section 907(a)(1)(A), we note that the Panel found that "[i]n the absence of any evidence or argument that such urgent problems of safety, health, environmental protection or national security arose or threatened to arise upon adoption of Section 907(a)(1)(A)", it could "only conclude that these urgent circumstances were not present".<sup>488</sup> Thus, the United States did not contend that the "urgent circumstances" referred to in Article 2.10 surrounded the adoption of Section 907(a)(1)(A).

294. With regard to the question of whether producers in Indonesia could have adapted to the requirements of Section 907(a)(1)(A) within a three-month period, the United States argued before the Panel that "Indonesian producers have been and are able to market tobacco-flavoured and menthol-flavoured cigarettes in the United States' market", and that "Indonesian producers, even 16 months after the enactment of [Section 907(a)(1)(A)] have not adjusted their product lines to produce tobacco or menthol-flavoured cigarettes."<sup>489</sup> Thus, according to the United States, whether it waited "three months or six months after the measure's enactment to allow it to enter into force appears not to have affected Indonesia producers in any way".<sup>490</sup> On appeal, the United States submits that "[t]his evidence and argument" was sufficient to rebut the *prima facie* case that the Panel found Indonesia to have established.<sup>491</sup> We are not persuaded that the evidence and argument submitted by the United States before the Panel was sufficient to establish that producers in Indonesia could have adapted to the requirements of Section 907(a)(1)(A) within a three-month period. Contrary to what the United States argues, the fact that Indonesian producers had not adjusted to the requirements of Section 907(a)(1)(A) sixteen months after its entry into force is evidence that points in the direction of Indonesian producers requiring a significantly longer period than the three months allowed by the United States. Thus, the United States failed to establish that producers in Indonesia could have adapted to the requirements of Section 907(a)(1)(A) within a three-month period.

295. We turn now to consider whether the United States established, with sufficient evidence and argument, that a period of at least six months between the publication and the entry into force of Section 907(a)(1)(A) would be ineffective in fulfilling the legitimate objective pursued by Section 907(a)(1)(A). We note that the Panel stated that the United States had not explained "why it deemed that allowing a 90 day/three month interval between the publication and entry into force of Section 907(a)(1)(A) was not ineffective in fulfilling the objective pursued by Section 907(a)(1)(A), while a six month interval would be".<sup>492</sup> Before the Panel, the United States argued that the

<sup>488</sup>Panel Report, para. 7.507.

<sup>489</sup>Panel Report, para. 7.583 (referring to United States' first written submission to the Panel, para. 303).

<sup>490</sup>Panel Report, para. 7.583.

<sup>491</sup>United States' appellant's submission, para. 153.

<sup>492</sup>Panel Report, para. 7.593.

FSPTCA "directly addresses a serious problem—youth smoking" and that "Congress intended to limit this behaviour as much as practicable".<sup>493</sup> While the arguments advanced by the United States before the Panel identify the legitimate objective of Section 907(a)(1)(A), these arguments are insufficient to establish that allowing a period of not less than six months between the publication and entry into force of Section 907(a)(1)(A) would have been ineffective to fulfil the legitimate objective of Section 907(a)(1)(A).

296. Thus, while we disagree with the Panel that it was for Indonesia to establish a *prima facie* case that an interval of at least six months between the publication of the FSPTCA and the entry into force of Section 907(a)(1)(A) would not render the fulfilment of the objective pursued by Section 907(a)(1)(A) ineffective, we nevertheless share the Panel's view that the United States failed to establish that an interval of at least six months between publication and entry into force would be ineffective in fulfilling the legitimate objective pursued by Section 907(a)(1)(A). Accordingly, we agree with the Panel that the United States failed to rebut the *prima facie* case of inconsistency that Indonesia established under Article 2.12 of the *TBT Agreement*.

297. In the light of the foregoing reasons, we *uphold*, albeit for different reasons, the Panel's finding, in paragraphs 7.595 and 8.1(h) of the Panel Report, that, by failing to allow an interval of not less than six months between the publication and the entry into force of Section 907(a)(1)(A) of the FFDCA, the United States acted inconsistently with Article 2.12 of the *TBT Agreement*.

## VII. Findings and Conclusions

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

- (a) With respect to Article 2.1 of the *TBT Agreement*:
- (i) upholds, albeit for different reasons, the Panel's finding, in paragraph 7.248 of the Panel Report, that clove cigarettes and menthol cigarettes are "like products" within the meaning of Article 2.1 of the *TBT Agreement*;
  - (ii) finds that the Panel did not act inconsistently with Article 11 of the DSU in its analysis of consumer tastes and habits;
  - (iii) upholds, albeit for different reasons, the Panel's finding, in paragraph 7.292 of the Panel Report, that, by banning clove cigarettes while exempting menthol cigarettes from the ban, Section 907(a)(1)(A) of the FFDCA accords imported clove cigarettes less favourable treatment than that accorded to

<sup>493</sup>Panel Report, para. 7.588 (referring to United States' first written submission to the Panel, para. 302).

domestic menthol cigarettes, within the meaning of Article 2.1 of the *TBT Agreement*;

- (iv) finds that the Panel did not act inconsistently with Article 11 of the DSU in its less favourable treatment analysis; and, therefore,
- (v) upholds, albeit for different reasons, the Panel's finding, in paragraphs 7.293 and 8.1(b) of the Panel Report, that Section 907(a)(1)(A) of the FFDCA is inconsistent with Article 2.1 of the *TBT Agreement* because it accords to imported clove cigarettes less favourable treatment than that accorded to like menthol cigarettes of national origin; and

(b) With respect to Article 2.12 of the *TBT Agreement*:

- (i) upholds the Panel's finding, in paragraph 7.576 of the Panel Report, that paragraph 5.2 of the Doha Ministerial Decision constitutes a subsequent agreement between the parties, within the meaning of Article 31(3)(a) of the *Vienna Convention*, on the interpretation of the term "reasonable interval" in Article 2.12 of the *TBT Agreement*; and

- (ii) upholds, albeit for different reasons, the Panel's finding, in paragraphs 7.595 and 8.1(h) of the Panel Report, that, by failing to allow an interval of not less than six months between the publication and the entry into force of Section 907(a)(1)(A) of the FFDCA, the United States acted inconsistently with Article 2.12 of the *TBT Agreement*.

299. The Appellate Body recommends that the DSB request the United States to bring its measure, found in this Report, and in the Panel Report as modified by this Report, to be inconsistent with the *TBT Agreement*, into conformity with its obligations under that Agreement.

Signed in the original in Geneva this 22nd day of March 2012 by:

\_\_\_\_\_  
Shotaro Oshima  
Presiding Member

\_\_\_\_\_  
Ricardo Ramirez-Hernández  
Member

\_\_\_\_\_  
Peter Van den Bossche  
Member

ANNEX I

# WORLD TRADE ORGANIZATION

WT/DS406/6  
10 January 2012

(12-0103)

Original: English

## UNITED STATES – MEASURES AFFECTING THE PRODUCTION AND SALE OF CLOVE CIGARETTES

Notification of an Appeal by the United States  
under Article 16.4 and Article 17 of the Understanding on Rules  
and Procedures Governing the Settlement of Disputes (DSU),  
and under Rule 20(1) of the Working Procedures for Appellate Review

The following notification, dated 5 January 2012, from the Delegation of the United States, is being circulated to Members.

Pursuant to Article 16 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") and Rule 20 of the *Working Procedures for Appellate Review*, the United States hereby notifies its decision to appeal to the Appellate Body certain issues of law covered in the Report of the Panel in *United States – Measures Affecting the Production and Sale of Clove Cigarettes* (WT/DS406/R) ("Panel Report") and certain legal interpretations developed by the Panel.

1. The United States seeks review of the Panel's conclusion that Section 907(a)(1)(A) of the Family Smoking Prevention and Tobacco Control Act (the "Tobacco Control Act"),<sup>1</sup> is inconsistent with Article 2.1 of the *Agreement on Technical Barriers to Trade* (the "TBT Agreement").<sup>2</sup> The United States appeals this finding based on a series of erroneous legal interpretations developed by the Panel, and on failure by the Panel to make an objective assessment of the facts of the case as called for by Article 11 of the DSU.

2. The United States seeks review of the Panel's finding that clove cigarettes and menthol cigarettes are like products.<sup>3</sup> In making this erroneous finding, the Panel erred in its legal interpretation of Article 2.1 by excluding, *a priori*, evidence related to particular criteria and failing to analyze each criteria completely.<sup>4</sup> Specifically the Panel erred by failing to perform a complete analysis of the end-uses<sup>5</sup> of clove cigarettes and menthol cigarettes and failing to perform a complete

<sup>1</sup>The Tobacco Control Act was adopted June 2009 and it went into effect September 2009 as an amendment to the Federal Food, Drug and Cosmetic Act, 21 U.S.C. §387g(a)(1)(A).

<sup>2</sup>See, e.g., Panel Report, paras. 7.293, 8.1(b).

<sup>3</sup>See, e.g., Panel Report, para. 7.248.

<sup>4</sup>See, e.g., Panel Report, paras. 7.116, 7.119, 7.197-199, 7.206, 7.209-210, 7.214, 7.230-231.

<sup>5</sup>See, e.g., Panel Report, paras. 7.197-199.

analysis of consumer tastes and habits.<sup>6</sup> In developing this faulty legal interpretation, the Panel also acted inconsistently with Article 11 of the DSU by failing to make an objective assessment of the facts in the case by refusing to consider certain evidence related consumer tastes and habits.<sup>7</sup>

3. The United States also seeks review of the Panel's finding that Section 907(a)(1)(A) accords less favorable treatment to imported clove cigarettes.<sup>8</sup> In making this finding, the Panel erred in its legal interpretations that the only products to be compared are imported clove cigarettes and domestic menthol cigarettes,<sup>9</sup> and that the effect of Section 907(a)(1)(A) on U.S. production can be assessed by looking only at what products were on the market at the time the measure went into effect.<sup>10</sup> The Panel also erred by applying an incorrect legal framework to assess whether the alleged detriment to the competitive conditions for clove cigarettes could be explained by factors or circumstances unrelated to the foreign origin of the products.<sup>11</sup> In developing these faulty legal interpretations, the Panel also acted inconsistently with Article 11 of the DSU by failing to make an objective assessment of the facts of the case in finding that at the time of the ban, there were no domestic cigarettes with characterizing flavors other than menthol cigarettes,<sup>12</sup> and that Section 907(a)(1)(A) imposes no costs on any U.S. entity.<sup>13</sup>

4. The United States seeks review by the Appellate Body of the Panel's conclusion and related findings that by not allowing an interval of no less than six months between the publication and the entry into force of Section 907(a)(1)(A), the United States acted inconsistently with Article 2.12 of the TBT Agreement.<sup>14</sup> This conclusion is in error and is based on erroneous findings on issues of law and legal interpretations with respect to Article 2.12 of the TBT Agreement.<sup>15</sup>

5. Finally, the United States also makes a conditional appeal regarding the Panel's legal analysis with respect to Indonesia's claims under Article 2.2 of the TBT Agreement. Should Indonesia seek review by the Appellate Body of the Panel's findings with respect to Indonesia's claims under Article 2.2, the United States seeks review by the Appellate Body of the Panel's finding that it could draw upon jurisprudence developed under Article XX(b) of the *General Agreement on Tariffs and Trade 1994* when assessing the consistency of Section 907(a)(1)(A) with the requirement that technical regulations "not be more trade-restrictive than necessary to fulfill a legitimate objective."<sup>16</sup> While the United States agrees with the ultimate conclusion in the Panel Report regarding Indonesia's claims under Article 2.2 of the TBT Agreement, the United States considers the Panel's analysis on this particular aspect to be based on erroneous findings on issues of law and related legal interpretations with respect to Article 2.2 of the TBT Agreement.

<sup>6</sup>See, e.g., Panel Report, paras. 7.116, 7.119, 7.206-7.232.

<sup>7</sup>See, e.g., Panel Report, para. 7.210.

<sup>8</sup>See, e.g., Panel Report, para. 7.292.

<sup>9</sup>See, e.g., Panel Report, paras. 7.274, 7.277.

<sup>10</sup>See, e.g., Panel Report, para. 7.289.

<sup>11</sup>See, e.g., Panel Report, paras. 7.269, 7.286-7.291.

<sup>12</sup>See, e.g., Panel Report, para. 7.289.

<sup>13</sup>See, e.g., Panel Report, para. 7.289.

<sup>14</sup>See, e.g., Panel Report, paras. 7.595, 8.1(h).

<sup>15</sup>See, e.g., Panel Report, paras. 7.561-7.595.

<sup>16</sup>Panel Report, paras. 7.351-7.369.