

Law and Practice of the World Trade Organization

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Reading Pack II — Case Law

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WTO structure

All WTO members may participate in all councils, committees, etc, except Appellate Body, Dispute Settlement panels, and plurilateral committees.

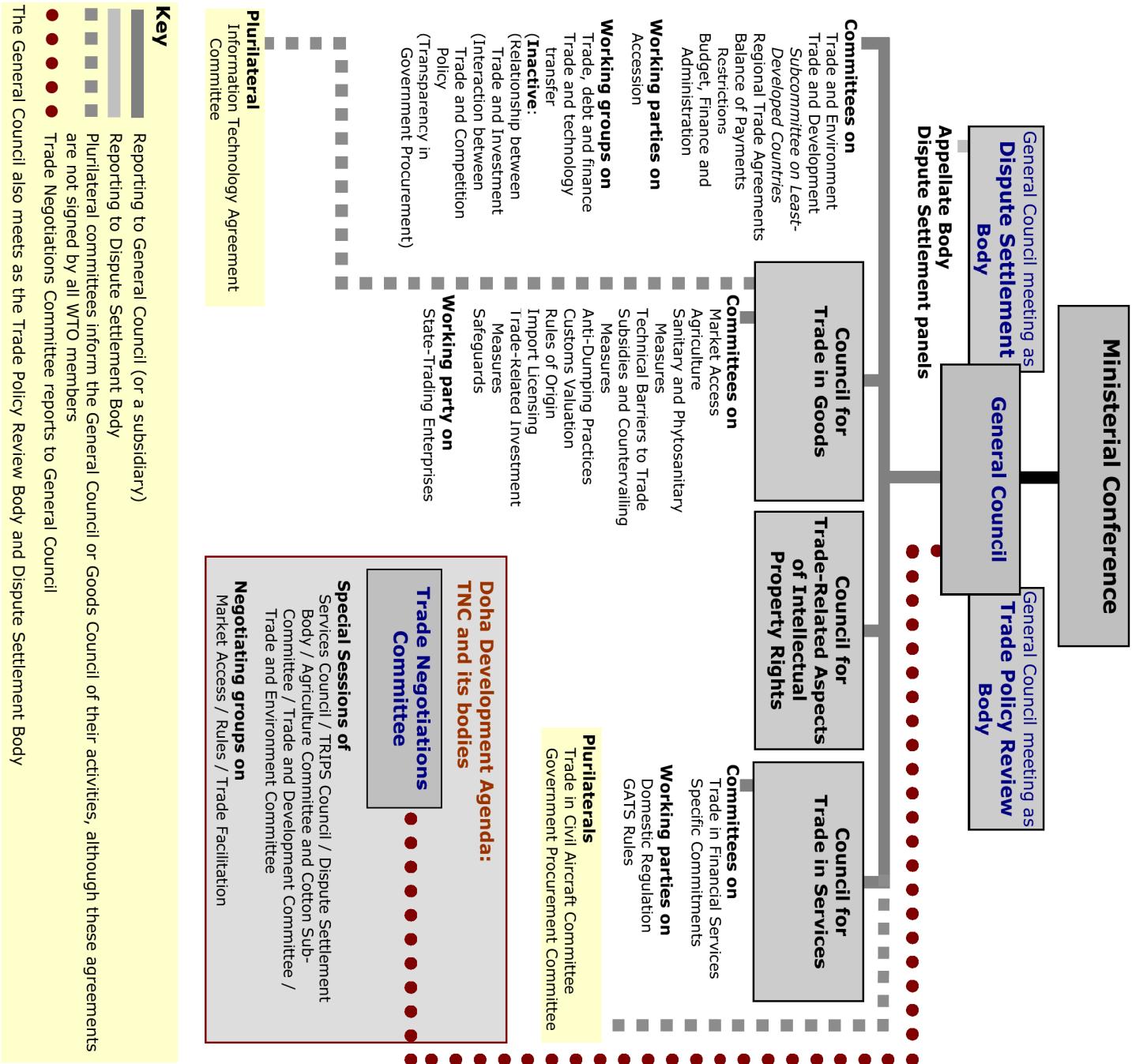


Figure A

Legal Structure of the Marrakesh Agreement Establishing the World Trade Organization

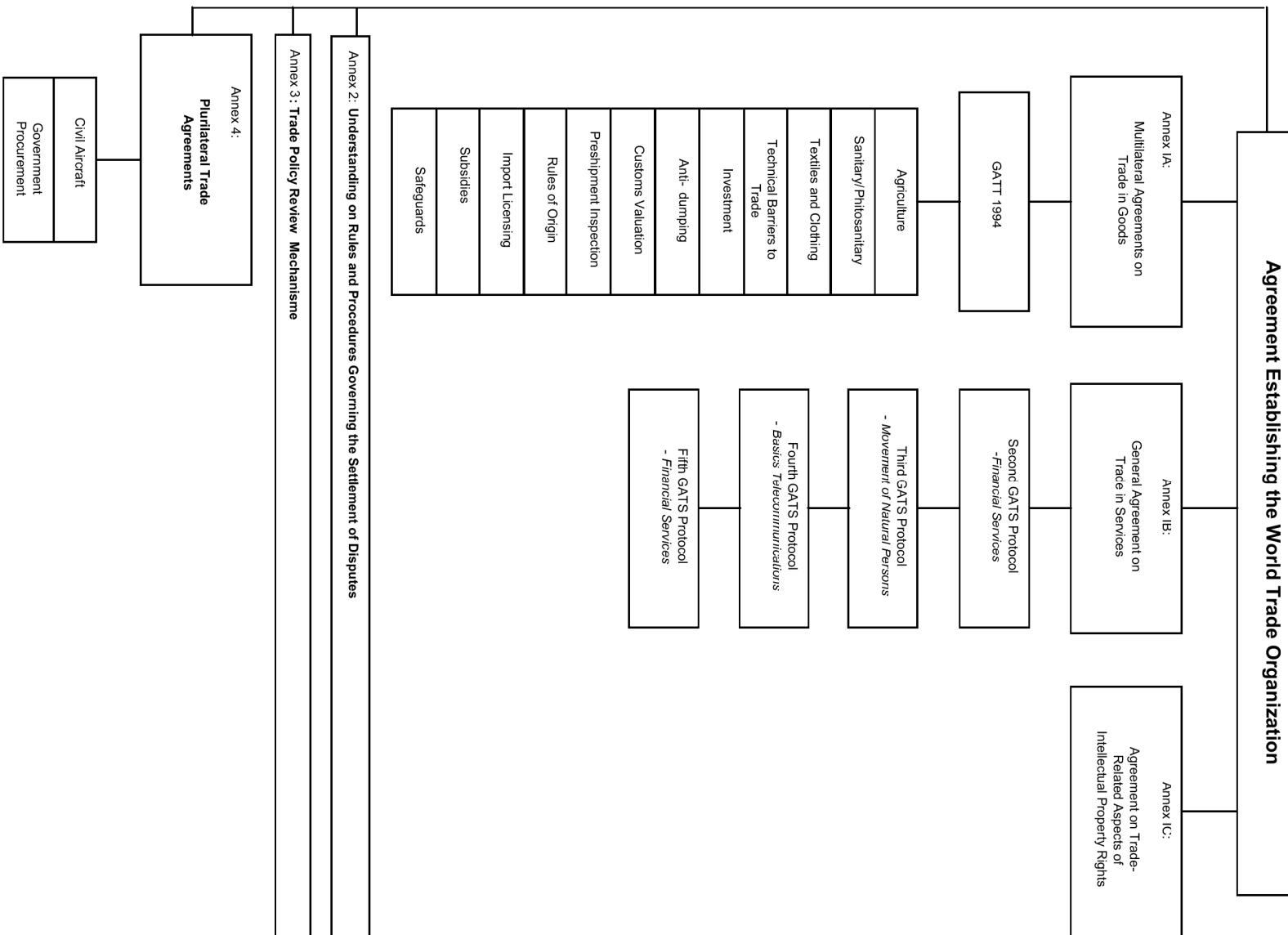
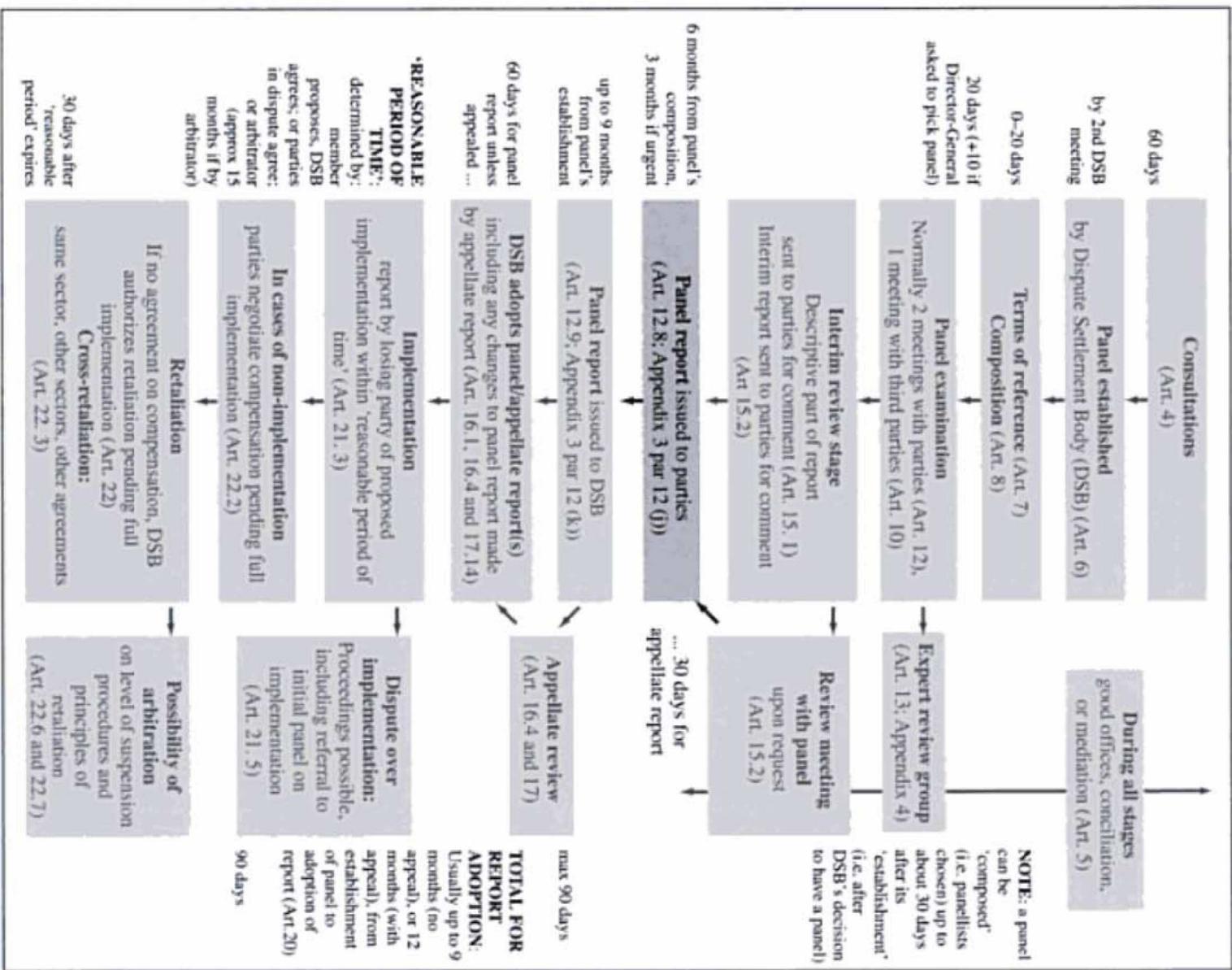


Figure 3.3 Flowchart of the WTO dispute settlement process¹²⁰

¹²⁰ See www.wto.org/english/law/wto_e/whatis_e/tif_e/disp2_e.htm, visited on 1 March 2004.

Appellate Body**Japan - Taxes on Alcoholic Beverages**

AB-1996-2

Report of the Appellate Body

Japan - Taxes on Alcoholic Beverages

AB-1996-2

Japan, Appellant/Appellee

United States, Appellant/Appellee

Canada, Appellee

European Communities, Appellee

Present:

Lacarte-Muró, Presiding Member

Bacchus, Member

El-Naggar, Member

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*¹ (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").²

The Panel Report was circulated to the Members of the World Trade Organization (the "WTO") on 11 July 1996. It contains the following conclusions:

- (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.

¹WT/DS8/R, WT/DS10/R, WT/DS11/R.

²Norway 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.

- (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 1994.³

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 1994.⁴

On 8 August 1996, Japan notified the Dispute Settlement Body⁵ 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").⁶ On 19 August 1996, Japan filed an appellant's submission.⁷ 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.⁸ The Division gave each participant an opportunity to respond to the written post-hearing memoranda of the other participants.⁹

³Panel Report, para. 7.1.

⁴Panel Report, para. 7.2.

⁵WT/DS8/9, WT/DS10/9, WT/DS11/6.

⁶WT/AB/WP/1.

⁷Pursuant to Rule 21(1) of the *Working Procedures*.

⁸Pursuant to Rule 28(1) of the *Working Procedures*.

⁹Pursuant to Rule 28(2) of the *Working Procedures*.

B. Arguments of Participants

1. Japan

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").¹⁰ 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

¹⁰Done at Marrakesh, Morocco, 15 April 1994 and entered into effect on 1 January 1995.

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 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")*,¹¹ 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".

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").¹² 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

¹¹Panel Report adopted on 19 June 1992, BISD 39S/206.

¹²23 May 1969, 1155 U.N.T.S. 331; 8 *International Legal Materials* 679.

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.¹³ The European Communities contend that the Panel made it clear that the essential criterion for a "like product" determination is similarity of physical 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.¹⁴

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

¹³Article 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.

¹⁴Article 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.

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 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:

1. 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*,¹⁵ 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".¹⁶ 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.¹⁷

Article 31, as a whole, and Article 32 are each highly pertinent to the present appeal. They provide as follows:

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.

¹⁵ Adopted 20 May 1996, WT/DS2/9.

¹⁶ *Ibid.*, at p. 17.

¹⁷ See e.g.: Jiménez de Aréchaga, "International Law in the Past Third of a Century" (1978-I) 159 *Recueil des Cours* p.1 at 42; *Territorial Dispute (Libyan Arab Jamahiriya/Chad), Judgment*, (1994), *LCJ Reports*, p. 6 at 20; *Maritime Delimitation and Territorial Questions between Qatar and Bahrain, Jurisdiction and Admissibility, Judgment*, (1995), *LCJ 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), *LCJ 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.

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".¹⁸ The

¹⁸ *Territorial Dispute (Libyan Arab Jamahiriya/Chad), Judgment*, (1994) *LCJ Reports*, p. 6 at 20; *Maritime Delimitation and Territorial Questions between Qatar and Bahrain, Jurisdiction and Admissibility, Judgment*, (1995) *LCJ Reports*, p. 6 at 18.

provisions of the treaty are to be given their ordinary meaning in their context.¹⁹ The object and purpose of the treaty are also to be taken into account in determining the meaning of its provisions.²⁰ 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*).²¹ 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".²²

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".²³

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

¹⁹See, e.g., *Competence of the General Assembly for the Admission of a State to the United Nations (Second Admissions Case)* (1950), *ICJ 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".

²⁰That 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-I) 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. I, 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), *ICJ Reports*, p. 128 at 336; *Re Competence of Conciliation Commission* (1955), 22 *International Law Reports*, p. 867 at 871.

²¹See 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."

²²*United States - Standards for Reformulated and Conventional Gasoline*, WT/DS2/9, adopted 20 May 1996, p. 23.

²³Panel Report, para. 6.10.

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.²⁴ An isolated act is generally not sufficient to establish subsequent practice,²⁵ it is a sequence of acts establishing the agreement of the parties that is relevant.²⁶

Although GATT 1947²⁷ panel reports were adopted by decisions of the CONTRACTING PARTIES²⁸, 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.²⁹

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.

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

²⁴Sinclair, *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-III) 151 *Recueil des Cours* p. 1 at 48.

²⁵Sinclair, *supra*, footnote 24, p. 137.

²⁶(1966) *Yearbook of the International Law Commission*, Vol. II, p. 222; Sinclair, *supra*, footnote 24, p. 138.

²⁷By 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.

²⁸By CONTRACTING PARTIES, we refer throughout to the CONTRACTING PARTIES of GATT 1947.

²⁹*European Economic Community - Restrictions on Imports of Dessert Apples*, BISD 36S/93, para. 12.1.

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.³⁰ 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*.

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

³⁰It 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.

endorsed through decisions by the CONTRACTING PARTIES to GATT or WTO Members".³¹ 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".³²

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.*

³¹Panel Report, para. 6.10.

³²Ibid.

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'".³³ Toward this end, Article III obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products.³⁴ "[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".³⁵ 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.³⁶ 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,³⁷ the statement in Paragraph 6.13 of the Panel Report that "one of the main purposes of Article III is to guarantee that

³³United States - Section 337 of the Tariff Act of 1930, BISD 36S/345, para. 5.10.

³⁴United 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).

³⁵Italian Discrimination Against Imported Agricultural Machinery, BISD 7S/60, para. 11.

³⁶United States - Taxes on Petroleum and Certain Imported Substances, BISD 34S/136, para. 5.1.9.

³⁷Japan - 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.

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 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.³⁸ This is confirmed by the negotiating history of Article III.³⁹

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

³⁸Brazilian 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.

³⁹At 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.

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".⁴⁰ 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

⁴⁰Panel Report, para. 6.12.

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.⁴¹

This approach to an examination of Article III:2, first sentence, is consistent with past practice under the GATT 1947.⁴² 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".⁴³

(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

⁴¹In 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.

⁴²See *Brazilian Internal Taxes*, BISD II/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.

⁴³*Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.5(c).

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.⁴⁴

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.⁴⁵

This approach was followed in almost all adopted panel reports after *Border Tax Adjustments*.⁴⁶ 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

⁴⁴We 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:

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.

⁴⁵Report of the Working Party on *Border Tax Adjustments*, BISD 18S/97, para. 18.

⁴⁶The Australian Subsidy on Ammonium Sulphate, BISD II/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.

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 accordion. The accordion of "likeness" stretches and squeezes in different places as different provisions of the *WTO 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 accordion 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.⁴⁷ For example, in the 1987 *Japan - Alcohol* Panel Report, the panel examined certain

⁴⁷EEC - 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.

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.⁴⁸

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.⁴⁹ 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:2.⁵⁰

⁴⁸Japan - *Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.6.

⁴⁹For 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.

⁵⁰We 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.

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.

(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."⁵¹ 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.

⁵¹United 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.

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.⁵² 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.

⁵²The 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.

(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"⁵³. 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"⁵⁴ 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.⁵⁵

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.

⁵³Panel Report, para. 6.22.

⁵⁴United States Appellant's Submission, dated 23 August 1996, para. 98, p.63. (emphasis added)

⁵⁵Panel Report, para 6.22.

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 address the full range of alcoholic beverages included in the Panel's Terms of Reference.⁵⁶ 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

⁵⁶The 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".

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 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.⁵⁷ 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

⁵⁷Panel Report, para. 6.33.

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".⁵⁸ This is an issue of how the measure in question is *applied*.

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.⁵⁹

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.⁶⁰ 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".⁶¹

⁵⁸Emphasis added.

⁵⁹*Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.11.

⁶⁰*Ibid.*

⁶¹*Ibid.*

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 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.⁶²

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.

⁶²*Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, BISD 34S/83, para. 5.9(c).

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.⁶³

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,

⁶³Panel Report, para 6.33.

must be done of each and all relevant facts and all the relevant circumstances in order to determine "the existence of protective taxation".⁶⁴ 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:

...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.⁶⁵

Our interpretation of Article III is faithful to the "customary rules of interpretation of public international law".⁶⁶ 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 real cases 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.⁶⁷

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";

⁶⁴Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages, BISD 34S/83, para. 5.11.

⁶⁵Panel Report, para. 6.35.

⁶⁶Article 3.2 of the DSU.

⁶⁷*Ibid.*

- (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.

Signed in the original at Geneva this 25th day of September 1996 by:

Julio Lacarte-Muró
Presiding Member

James Bacchus
Member

Said El-Naggar
Member

**WORLD TRADE
ORGANIZATION**

WT/DS58/AB/R
12 October 1998

(98-0000)

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**UNITED STATES - IMPORT PROHIBITION OF
CERTAIN SHRIMP AND SHRIMP PRODUCTS**

AB-1998-4

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WORLD TRADE ORGANIZATION
APPELLATE BODY

United States – Import Prohibition of Certain Shrimp and Shrimp Products

United States, *Appellant*
India, Malaysia, Pakistan, Thailand, *Appellees*

Australia, Ecuador, the European Communities, Hong Kong, China, Mexico and Nigeria, *Third Participants*

AB-1998-4

Present:

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*.¹ Following a joint request for consultations by India, Malaysia, Pakistan and Thailand on 8 October 1996², Malaysia and Thailand requested in a communication dated 9 January 1997³, and Pakistan asked in a communication dated 30 January 1997⁴, 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 101-162⁵ ("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.⁶ On

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 1997⁷, and agreed that this third panel, too, would be merged into the earlier Panel established on 25 February 1997.⁸ 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 1973⁹ 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.¹⁰ 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

¹WT/DS58/R, 15 May 1998.

²WT/DS58/1, 14 October 1996.

³WT/DS58/6, 10 January 1997.

⁴WT/DS58/7, 7 February 1997.

⁵16 United States Code (U.S.C.) §1537.

⁶WT/DSB/M/29, 26 March 1997.

⁷WT/DS58/8, 4 March 1997.

⁸WT/DSB/M/31, 12 May 1997.

⁹Public Law 93-205, 16 U.S.C. 1531 *et seq.*

¹⁰52 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 kempii*), green (*Chelonia mydas*), leatherback (*Dermochelys coriacea*) and hawksbill (*Eretmochelys imbricata*).

and 1996¹¹: 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.¹² 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."¹³

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.¹⁴ 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."¹⁵ 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.¹⁶ Other measures that the harvesting nation undertakes for the protection of sea turtles will also be taken into account in making the comparability determination.¹⁷ 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 ...".¹⁸

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

¹¹Hereinafter 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.

¹²Section 609(b)(2)(C).

¹³1996 Guidelines, p. 17343.

¹⁴Section 609(b)(2)(A) and (B).

¹⁵1996 Guidelines, p. 17344.

¹⁶*Ibid.*

¹⁷*Ibid.*

¹⁸*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."¹⁹ 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.²⁰ 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.²¹ 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 1996.²² 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.²³

6. The 1991 Guidelines limited the geographical scope of the import ban imposed by Section 609 to countries in the wider Caribbean/western Atlantic region²⁴, 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 1996.²⁵ 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.²⁶ On

¹⁹1996 Guidelines, p. 17343.

²⁰*Earth Island Institute v. Warren Christopher*, 942 Fed. Supp. 597 (CIT 1996).

²¹*Earth Island Institute v. Warren Christopher*, 948 Fed. Supp. 1062 (CIT 1996).

²²1998 U.S. App. Lexis 11789.

²³Response by the United States to questioning at the oral hearing.

²⁴Specifically, Mexico, Belize, Guatemala, Honduras, Nicaragua, Costa Rica, Panama, Colombia, Venezuela, Trinidad and Tobago, Guyana, Suriname, French Guyana and Brazil.

²⁵*Earth Island Institute v. Warren Christopher*, 913 Fed. Supp. 559 (CIT 1995).

²⁶*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 1994.²⁷

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.²⁸

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 appeal²⁹ 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.³⁰ On 7 August 1998, India, Pakistan and Thailand ("Joint Appellees") filed a joint appellees' submission and Malaysia filed a separate appellee's submission.³¹ On the same day, Australia, Ecuador, the European Communities, Hong Kong, China, and Nigeria each filed separate third participants' submissions.³² 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.

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

²⁷Panel Report, para. 8.1.

²⁸Panel Report, para. 8.2.

²⁹WT/DS58/11, 13 July 1998.

³⁰Pursuant to Rule 21(1) of the *Working Procedures for Appellate Review*.

³¹Pursuant to Rule 22(1) of the *Working Procedures for Appellate Review*.

³²Pursuant to Rule 24 of the *Working Procedures for Appellate Review*.

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*³³ (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*³⁴ ("United States – Gasoline") and with the

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

³³Done at Marrakesh, 15 April 1994.

³⁴Adopted 20 May 1996, WT/DS2/AB/R.

of the international law principle according to which international agreements must be applied in good faith; and the *Belgian Family Allowances*³⁵ 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*³⁶ 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

³⁵Adopted 7 November 1952, BISD 1S/59.

³⁶Adopted 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*³⁷ 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).

³⁷Adopted 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 Fauna³⁸ (the "CITES") since 1975, and other international agreements also recognize the endangered status of sea turtles.³⁹ 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."⁴⁰ 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

³⁸Done at Washington, 3 March 1973, 993 U.N.T.S. 243, 12 International Legal Materials 1085.

³⁹The 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.

⁴⁰The 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."⁴¹ 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.

⁴¹Joint Appellees refer to Panel Report, para. 7.8.

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

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 Treaties⁴² (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*⁴³, 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.

⁴²Done at Vienna, 23 May 1969, 1155 U.N.T.S. 33; 8 International Legal Materials 679.

⁴³Unadopted, 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*⁴⁴ 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 applied⁴⁵; 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 XX⁴⁶; 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 1994.⁴⁷

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."⁴⁸ 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*⁴⁹ 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*⁵⁰, the Appellate Body should examine the manner in which Section 609 has been applied, and decide whether an

⁴⁴Adopted 20 May 1996, WT/DS2/AB/R.

⁴⁵*United States – Gasoline*, adopted 20 May 1996, WT/DS2/AB/R, page 22.

⁴⁶*Ibid.*

⁴⁷*Ibid.*

⁴⁸Joint Appellees refer to Panel Report, para 7.40.

⁴⁹Adopted 7 November 1952, BISD 1S/59.

⁵⁰Adopted 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 Development⁵¹, and was underscored by the Appellate Body in *United States - Gasoline*.⁵² 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

⁵¹UN Doc. A/CONF. 151/5/Rev.1, 13 June 1992, 31 International Legal Materials 874.

⁵²Adopted 20 May 1996, WT/DS2/AB/R, pp. 27-28.

Body Report in *United States - Gasoline*⁵³ 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*⁵⁴ 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).

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 provisions 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*⁵⁵ to the facts of this case, and misconstrues the Panel's application of the *Belgian Family Allowances*⁵⁶ 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

⁵³Adopted 20 May 1996, WT/DS2/AB/R.

⁵⁴Ibid.

⁵⁵Adopted 16 January 1998, WT/DS50/AB/R.

⁵⁶Adopted 7 November 1952, BISD 1S/59.

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*.⁵⁷ 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.

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

⁵⁷Adopted 20 May 1996, WT/DS2/AB/R.

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.⁵⁸

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

⁵⁸Adopted 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 Community⁵⁹ 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.⁶⁰

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*⁶¹ -- 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.

⁵⁹Done at Rome, 25 March 1957, as amended.

⁶⁰The 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 Gabcikovo-Nagymaros Project*, (1998) 37 International Legal Materials 162, para. 140.

⁶¹Adopted 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.⁶² 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

⁶²Done 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*⁶³, 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*⁶⁴, 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

⁶³Adopted 20 May 1996, WT/DS2/AB/R, page 22.

⁶⁴*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.⁶⁵

⁶⁵Nigeria 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 organizations⁶⁶: 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 Sobrevida; 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

⁶⁶In 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.

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?

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 terse⁶⁷, 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.

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.⁶⁸ The Panel disposed of this matter in the following manner:

⁶⁷The 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.

⁶⁸Panel Report, para. 3.129

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.⁶⁹(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.⁷⁰ 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

submissions considered by, a panel.⁷¹ 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 DSU⁷² "enable[s] panels to seek information and advice as they deem appropriate in a particular case."⁷³ Also, in *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, we ruled that:

⁶⁹Panel Report, para. 7.8.

⁷⁰See Articles 4, 6, 9 and 10 of the DSU.

⁷¹Articles 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.

⁷²As well as Article 11.2 of the *Agreement on the Application of Sanitary and Phytosanitary Measures*.

⁷³Adopted 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.*⁷⁴ (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)

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

⁷⁴ Adopted 22 April 1998, WT/DS56/AB/R, paras. 84-86.

the Panel, they were free to do so.⁷⁵ 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 issue⁷⁶ 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*:

... [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.⁷⁷

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.⁷⁸

⁷⁵Panel Report, para. 7.8.

⁷⁶The 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.

⁷⁷Panel Report, para. 7.44.

⁷⁸Panel 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.⁷⁹

... 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.⁸⁰

...

We therefore find that the *US measure at issue is not within the scope of measures permitted under the chapeau of Article XX.*⁸¹(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

times⁸², 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.⁸³

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.*"⁸⁴(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."⁸⁵(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*

⁸²See, 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.

⁸³I. Sinclair, *The Vienna Convention on the Law of Treaties*, 2nd ed. (Manchester University Press, 1984), pp. 130-131.

⁸⁴Adopted 20 May 1996, WT/DS2/AB/R, p. 22.

⁸⁵Panel 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)

⁷⁹Panel Report, para. 7.48.

⁸⁰Panel Report, para. 7.49.

⁸¹Panel Report, para. 7.62.

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"⁸⁶ must be regarded as "not within the scope of measures permitted under the chapeau of Article XX."⁸⁷ 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]'*".⁸⁸(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."⁸⁹ 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)."⁹⁰ 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*.⁹¹(emphasis added)

...

⁸⁶See, for example, Panel Report, para. 7.44.

⁸⁷Panel Report, para. 7.62.

⁸⁸Adopted 20 May 1996, WT/DS2/AB/R, p. 22.

⁸⁹Panel Report, para. 7.29.

⁹⁰*Ibid.*

⁹¹Panel 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*.⁹²(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."⁹³ 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*

⁹²Adopted 20 May 1996, WT/DS2/AB/R, p. 22.

⁹³Panel Report, para. 7.28.

materiae, fall outside the justifying protection of Article XX's chapeau.⁹⁴ 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"⁹⁵, 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.⁹⁶

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*

⁹⁴See, for example, Panel Report, para. 7.50.

⁹⁵Panel Report, para. 7.62.

⁹⁶Adopted 23 July 1998, WT/DS69/AB/R, para. 156.

*Periodicals*⁹⁷, 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*⁹⁸, 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).⁹⁹ 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;

1. "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

⁹⁷Adopted 30 July 1997, WT/DS31/AB/R, pp. 23 and 24.

⁹⁸Adopted 20 May 1996, WT/DS2/AB/R, pp. 19 ff.

⁹⁹Additional 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."¹⁰⁰ 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."¹⁰¹ Moreover, they argued, if "all" natural resources were considered to be exhaustible, the term "exhaustible" would become superfluous.¹⁰² 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.¹⁰³ 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".¹⁰⁴ It followed, according to Malaysia, that the United States cannot invoke both the Article XX(b) and the Article XX(g) exceptions simultaneously.¹⁰⁵

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.¹⁰⁶

¹⁰⁰Panel Report, para. 3.237.

¹⁰¹*Ibid.*

¹⁰²*Ibid.*

¹⁰³Panel 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.

¹⁰⁴Panel Report, para. 3.240.

¹⁰⁵*Ibid.*

¹⁰⁶We 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"¹⁰⁷ⁿ.

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, ...*¹⁰⁸(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".¹⁰⁹ 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

¹⁰⁷This 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.

¹⁰⁸Preamble of the *WTO Agreement*.

¹⁰⁹See *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-I) 159 *Recueil des Cours* 1, p. 49.

Sea¹¹⁰ ("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 Diversity¹¹¹ uses the concept of "biological resources". Agenda 21¹¹² 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; ...¹¹³ (emphasis added)

¹¹⁰Done 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.

¹¹¹Done 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.

¹¹²Adopted 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.

¹¹³Final 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.¹¹⁴ Moreover, two adopted GATT 1947 panel reports previously found fish to be an "exhaustible natural resource" within the meaning of Article XX(g).¹¹⁵ We hold that, in line with the principle of effectiveness in treaty interpretation¹¹⁶, 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 1 of the Convention on International Trade in Endangered Species of Wild Fauna and Flora ("CITES"). The list in Appendix 1 includes "all species *threatened with extinction* which are or may be affected by trade."¹¹⁷ (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:

¹¹⁴Furthermore, 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).

¹¹⁵*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.

¹¹⁶See 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. I (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/Martinus 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* (Tipografica Editora Argentina, 1985), pp. 109-110 and M. Diez de Velasco, *Instituciones de Derecho Internacional Público*, 11th ed. (Tecnos, 1997), p. 169.

¹¹⁷CITES, 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.* ...¹¹⁸(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.¹¹⁹ 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.¹²⁰ None of the parties to this dispute question the genuineness of the commitment of the others to that policy.¹²¹

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

¹¹⁸Panel Report, para. 7.53.

¹¹⁹See 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."

¹²⁰There are currently 144 states parties to CITES.

¹²¹We 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.¹²² 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).¹²³

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.¹²⁴ 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.

¹²²Adopted 20 May 1996, WT/DS2/AB/R, p. 19.

¹²³*Ibid.*

¹²⁴See 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.¹²⁵ 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 Panel¹²⁶, 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."¹²⁷

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 stake¹²⁸, 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.

¹²⁵See the 1996 Guidelines, p. 17343.

¹²⁶For example, Panel Report, paras. 5.91-5.118.

¹²⁷Panel Report, para. 7.60, footnote 674.

¹²⁸We 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.¹²⁹

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.¹³⁰ 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"¹³¹, with certain limited exceptions.¹³² Penalties for violation of the Endangered Species Act, or the regulations issued thereunder, include civil and criminal sanctions.¹³³ The United States government currently relies on monetary sanctions and civil penalties for enforcement.¹³⁴ The government has the ability to seize

¹²⁹Adopted 20 May 1996, WT/DS2/AB/R, pp. 20-21.

¹³⁰52 Fed. Reg. 24244, 29 June 1987.

¹³¹See the 1996 Guidelines, p. 17343.

¹³²According 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.

¹³³Endangered Species Act, Section 11.

¹³⁴Statement 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.¹³⁵ 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.

1. 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:

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.¹³⁶

...

[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.¹³⁷ (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

¹³⁶United States appellant's submission, para. 28.

¹³⁷United States appellant's submission, para. 53.

¹³⁵Statement by the United States at the oral hearing.

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.¹³⁸ 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.¹³⁹ 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]'."¹⁴⁰ 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.¹⁴¹

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.¹⁴² In recognition of the importance of continuity with the previous GATT system, negotiators used the

¹³⁸In *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."

¹³⁹*Ibid.*, pp. 23-24.

¹⁴⁰*Ibid.*, p. 22.

¹⁴¹*Ibid.*

¹⁴²*WTO Agreement*, Article III:1.

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, ...¹⁴³

153. We note once more¹⁴⁴ 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.¹⁴⁵

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, ...¹⁴⁶

¹⁴³Preamble of the *WTO Agreement*, first paragraph.

¹⁴⁴*Supra*, para. 129.

¹⁴⁵*Supra*, para. 131.

¹⁴⁶Preamble of the Decision on Trade and Environment.

In this Decision, Ministers took "note" of the Rio Declaration on Environment and Development¹⁴⁷, Agenda 21¹⁴⁸, 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 ..."¹⁴⁹ 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 affects, and of effective implementation of the multilateral disciplines governing those measures.¹⁵⁰

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

¹⁴⁷We 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."

¹⁴⁸Agenda 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."

¹⁴⁹Preamble of the Decision on Trade and Environment.

¹⁵⁰Decision 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, 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.¹⁵¹ This interpretation of the chapeau is confirmed by its negotiating

¹⁵¹This 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*.¹⁵¹ (emphasis added) Adopted 7 November 1989, BISD 365/345, para. 5.9.

history.¹⁵² The language initially proposed by the United States in 1946 for the chapeau of what would later become Article XX was unqualified and unconditional.¹⁵³ 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.¹⁵⁴ 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.¹⁵⁵ 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

¹⁵²Article 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.

¹⁵³The 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: ...

¹⁵⁴For 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

¹⁵⁵The 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."¹⁵⁶ 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.¹⁵⁷

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

¹⁵⁶B. 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.

¹⁵⁷Vienna 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.¹⁵⁸ 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.¹⁵⁹ Under these Guidelines, any exceptions to the requirement of the use of TEDs must be comparable to those of the United States

¹⁵⁸Pursuant 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...

¹⁵⁹1996 Guidelines, p. 17344.

program.¹⁶⁰ Furthermore, the harvesting country must have in place a "credible enforcement effort".¹⁶¹ 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"¹⁶², 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.¹⁶³

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.¹⁶⁴

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

¹⁶⁰As 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.

¹⁶¹1996 Guidelines, p. 17344.

¹⁶²*Ibid.*

¹⁶³Statements by the United States at the oral hearing.

¹⁶⁴Statement 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.¹⁶⁵(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

¹⁶⁵Panel 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 Turtles¹⁶⁶ (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.¹⁶⁷

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 21.¹⁶⁸ 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)

¹⁶⁶First written submission of the United States to the Panel, Exhibit AA.

¹⁶⁷Panel Report, para. 7.56.

¹⁶⁸See 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.¹⁶⁹ (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 countries¹⁷⁰, in addition to the United States, and four of these countries are currently certified under Section 609.¹⁷¹ 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,

¹⁶⁹Report (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.

¹⁷⁰Brazil, Costa Rica, Mexico, Nicaragua and Venezuela.

¹⁷¹As 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.¹⁷² 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].¹⁷³

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 1 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.

¹⁷²Inter-American Convention, Article IV.1.

¹⁷³Inter-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 turtles¹⁷⁴ 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.¹⁷⁵ 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

¹⁷⁴While 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.

¹⁷⁵Section 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 1996.¹⁷⁶ 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.¹⁷⁷

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

enforcement effort", and in implementing the compulsory use of TEDs on hundreds, if not thousands, of shrimp trawl vessels.¹⁷⁸

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.¹⁷⁹ 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.¹⁸⁰ Furthermore, there is little or no flexibility in how officials make the determination for certification

¹⁷⁶See *Earth Island Institute v. Warren Christopher*, 913 F. Supp. 559 (CIT 1995).

¹⁷⁷See *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.

¹⁷⁸For 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 ...".

¹⁷⁹Response by the United States to questioning by the Panel; statements by the United States at the oral hearing.

¹⁸⁰*Supra*, paras. 161-164.

pursuant to these provisions.¹⁸¹ 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.¹⁸²

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 ...".¹⁸³ 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.¹⁸⁴ 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.¹⁸⁵

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.¹⁸⁶ 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, reasoned decision,

¹⁸¹In 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."

¹⁸²Statement by the United States at the oral hearing.

¹⁸³1996 Guidelines, p. 17343.

¹⁸⁴Statement by the United States at the oral hearing.

¹⁸⁵Statement by the United States at the oral hearing.

¹⁸⁶Statement by the United States at the oral hearing.

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).¹⁸⁷ 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 denied¹⁸⁸ 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.¹⁸⁹ No procedure for review of, or appeal from, a denial of an application is provided.¹⁹⁰

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:3¹⁹¹ 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.

¹⁸⁷Statement by the United States at the oral hearing.

¹⁸⁸We were advised at the oral hearing by the United States that these include: Australia, Pakistan and Tunisia.

¹⁸⁹Statement by the United States at the oral hearing.

¹⁹⁰Statement by the United States at the oral hearing.

¹⁹¹Article 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*.¹⁹²

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.

¹⁹²Adopted 20 May 1996, WT/DS2/AB/R, p. 30.

Signed in the original at Geneva this 8th day of October 1998 by:

**WORLD TRADE
ORGANIZATION**

WT/DS58/AB/RW
22 October 2001

(01-5166)

Original: English

**UNITED STATES – IMPORT PROHIBITION OF CERTAIN
SHRIMP AND SHRIMP PRODUCTS**

RE COURSE TO ARTICLE 21.5 OF THE DSU BY MALAYSIA

AB-2001-4

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WORLD TRADE ORGANIZATION
APPELLATE BODY

United States – Import Prohibition of Certain Shrimp and Shrimp Products

Recourse to Article 21.5 of the DSU by Malaysia

Malaysia, *Appellant*
United States, *Appellee*

Australia, *Third Participant*
European Communities, *Third Participant*
Hong Kong, China, *Third Participant*
India, *Third Participant*
Japan, *Third Participant*
Mexico, *Third Participant*
Thailand, *Third Participant*

AB-2001-4

Present:

Bacchus, Presiding Member
Ganesan, Member
Lacarte-Muró, Member

I. Introduction

1. Malaysia appeals from certain issues of law and legal interpretations in the Panel Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products, Recourse to Article 21.5 of the DSU by Malaysia* (the "Panel Report").¹ In accordance with Article 21.5 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), Malaysia requested that the Dispute Settlement Body (the "DSB") refer to a panel its complaint with respect to whether the United States had complied with the recommendations and rulings of the DSB in *United States – Import Prohibition of Certain Shrimp and Shrimp Products* ("United States – Shrimp").

2. The background to this dispute is set out in detail in the Panel Report.² On 6 November 1998, the DSB adopted the reports of the original panel and the Appellate Body in *United States – Shrimp*.³ The DSB recommended that the United States bring its import prohibition into conformity with its obligations under the *Marrakesh Agreement Establishing the World Trade Organization* (the "WTO Agreement"). On 6 December 1999, the period of time for implementation established by

¹WT/DS58/RW, 15 June 2001.

²Panel Report, paras. 1.1-1.5 and 2.12-2.21.

³Appellate Body Report, WT/DS58/AB/R, adopted 6 November 1998; original panel report, WT/DS58/R and Corr.1, as modified by the Appellate Body Report, WT/DS58/AB/R, adopted 6 November 1998.

the parties under Article 21.3(b) of the DSU expired.⁴ At the DSB meeting of 23 October 2000, Malaysia informed the DSB that it was not satisfied that the United States had complied with the recommendations and rulings of the DSB, and announced that it wished to seek recourse to a panel under Article 21.5 of the DSU.⁵ The DSB referred the matter to the original panel.

3. Malaysia's complaint relates to a measure taken by the United States in the form of an import prohibition to protect and conserve certain species of sea turtles, considered to be an endangered species. This original measure, Section 609 of the United States Public Law 101-162 ("Section 609"), and its application are described in detail in the Appellate Body Report in *United States – Shrimp*.⁶ The Appellate Body found that Section 609 was provisionally justified under Article XX(g) of the *General Agreement on Tariffs and Trade 1994* (the "GATT 1994"). In implementing the recommendations and rulings of the DSB, the United States did not amend Section 609, with the result that the import prohibition is still in effect. However, the United States Department of State issued the Revised Guidelines for the Implementation of Section 609 of Public Law 101-162 Relating to the Protection of Sea Turtles in Shrimp Trawl Fishing Operations (the "Revised Guidelines").⁷ These Revised Guidelines replace the guidelines issued in April 1996 that were part of the original measure. This dispute between Malaysia and the United States arises in relation to the import prohibition of shrimp and shrimp products provided for by Section 609, and its application by the United States.

4. Section 609, the Revised Guidelines, and their application, are described in the Panel Report.⁸ In the following paragraphs, we set out those aspects of the Revised Guidelines that are pertinent to the consideration of the issues raised in this appeal.

5. Section 609(b)(2) provides that the import prohibition on shrimp does not apply to harvesting nations that are "certified" according to criteria set by the United States. The Revised Guidelines set forth the criteria for certification. The stated goal of the programme set out in the Revised Guidelines is the same as that set out in the programme of the original guidelines, namely, to protect endangered sea turtle populations from further decline by reducing their incidental mortality in commercial

⁴WT/DS58/15, 15 July 1999.

⁵Malaysia's recourse to a panel was also in accordance with a bilateral agreement it had concluded with the United States in respect of the procedures to be followed under Articles 21.5 and 22 of the DSU. See, WT/DS58/16, 12 January 2000.

⁶Supra, footnote 3, paras. 3-6.

⁷United States Department of State, *Federal Register* Vol. 64, No. 130, 8 July 1999, Public Notice 3086, pp. 36946 – 36952. The Revised Guidelines are attached to the Panel Report.

⁸Panel Report, paras. 2.5 – 2.11 and 2.22 – 2.32.

shrimp trawling. A central element of the United States programme is that commercial shrimp trawlers are required to use Turtle Excluder Devices ("TEDs") approved in accordance with standards established by the United States National Marine Fisheries Service. Where the government of a harvesting country seeks certification on the basis of having adopted a programme that is based on TEDs, certification will be granted if this government's programme includes a requirement that commercial shrimp trawlers use TEDs that are "*comparable in effectiveness*" to those used in the United States, and a credible enforcement effort that includes monitoring for compliance.⁹

6. Under the original guidelines, the practice of the Department of State was to certify countries *only after* they had shown that they required the use of TEDs. Under the Revised Guidelines, countries may apply for certification even if they do not require the use of TEDs. In such cases, a harvesting country has to demonstrate that it has implemented, and is enforcing, a "*comparably effective*" regulatory programme to protect sea turtles without the use of TEDs. The Department of State is required "to take fully into account any demonstrated differences between the shrimp fishing conditions in the United States and those in other nations, as well as information available from other sources."¹⁰

7. An exporting country may also be certified if its shrimp fishing environment does not pose a threat of incidental capture of sea turtles. The Revised Guidelines provide that the Department of State shall certify a harvesting country pursuant to Section 609 if it meets any of the following criteria: the relevant species of sea turtles do not occur in waters subject to that country's jurisdiction; in that country's waters, shrimp is harvested exclusively by means that do not pose a threat to sea turtles, for example, any country that harvests shrimp exclusively by artisanal means; or, commercial shrimp trawling operations take place exclusively in waters in which sea turtles do not occur.¹¹

8. Before the Panel, Malaysia argued that the United States had failed to comply with the recommendations and rulings of the DSB, and that, consequently, the United States continued to violate its obligations under the GATT 1994. In its Report circulated on 15 June 2001, the Panel found as follows:

- (a) [t]he measure adopted by the United States in order to comply with the recommendations and rulings of the DSB violates Article XI.1 of the GATT 1994;
- (b) in light of the recommendations and rulings of the DSB, Section 609 of Public Law 101-162, as implemented by the Revised Guidelines of 8 July 1999 and as applied so far by the [United States] authorities, is justified under Article XX of the GATT 1994 as long as the conditions stated in the findings of this Report, in particular the ongoing serious good faith efforts to reach a multilateral agreement, remain satisfied.¹²

9. The Panel urged "Malaysia and the United States to cooperate fully in order to conclude as soon as possible an agreement which will permit the protection and conservation of sea turtles to the satisfaction of all interests involved and taking into account the principle that States have common but differentiated responsibilities to conserve and protect the environment."¹³ (footnote omitted)

10. On 23 July 2001, Malaysia 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 DSU, and filed a Notice of Appeal pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "*Working Procedures*"). On 2 August 2001, Malaysia filed its appellant's submission.¹⁴ On 17 August 2001, the United States filed an appellee's submission.¹⁵ On the same day, Australia, the European Communities, Hong Kong, China, India, Japan, Mexico and Thailand each filed a third participant's submission.¹⁶

11. On 13 August 2001, the United States requested that the Division hearing this appeal change the date of the oral hearing set out in the working schedule for this appeal. After inviting the participants to make their views known with respect to this request, the Division ruled that it would not change the date of the oral hearing. Accordingly, the oral hearing in the appeal was held on 4 September 2001. The participants and third participants presented oral arguments and responded to questions put to them by the Members of the Division.

⁹Panel Report, para. 2.25.

¹⁰Ibid., para. 2.28.

¹¹Ibid., para. 2.29.

¹²Ibid., para. 7.2.

¹³Pursuant to Rule 21 of the *Working Procedures*.

¹⁴Pursuant to Rule 22 of the *Working Procedures*.

¹⁵Pursuant to Rule 24 of the *Working Procedures*. Ecuador, a third party in the proceedings before the Panel, did not file a third participant's submission, but requested permission to attend the oral hearing as a "passive observer". After consulting the participants and third participants, the Division hearing this appeal granted Ecuador permission to attend the oral hearing in this capacity.

II. Arguments of the Participants and the Third Participants

A. Claims of Error by Malaysia – Appellant

1. Terms of Reference

12. Malaysia submits that the Panel erred in its examination of the new measure taken by the United States to comply with the recommendations and rulings of the DSB in *United States – Shrimp*.

13. Malaysia submits that it is a legal principle that an implementing measure must be examined for conformity with the covered agreements rather than for conformity with the recommendations and rulings of the DSB. This principle is borne out in the case in *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU* ("*Canada – Aircraft (21.5)*")¹⁷, where the Appellate Body held that the scope of Article 21.5 dispute settlement proceedings is not limited to the issue of whether or not a WTO Member has implemented the recommendations and rulings of the DSB. The Appellate Body ruled that the task of the panel was to determine whether the new measure is consistent with the disputed provisions of the *WTO Agreement*.

14. Malaysia submits that, in carrying out its review under Article 21.5 of the DSU, a panel is not confined to examining the "measure taken to comply" only from the perspective of the claims, arguments and factual circumstances that relate to the measure that was the subject of the original proceedings. Although these may have some relevance in proceedings under Article 21.5 of the DSU, Malaysia submits that Article 21.5 proceedings involve, in principle, not the original measure, but rather a new and different measure that was not before the original panel. In Malaysia's view, the utility of the review envisaged under Article 21.5 of the DSU would be seriously undermined if a panel were restricted to examining the new measure from the perspective of the claims, arguments and factual circumstances that related to the original measure.

15. Malaysia argues that the Panel erred in its treatment of the Appellate Body Report in *United States – Shrimp*. First, Malaysia asserts that in relying solely on the reasoning of the Appellate Body, the Panel has in fact relied on the claims and arguments brought by the parties that related to the original measure. Second, Malaysia argues that the Panel erred in treating the Appellate Body Report in *United States – Shrimp* as having proposed alternative courses of conduct or alternative measures as *conditions* which, if fulfilled, would necessarily render the implementing measure

consistent with the relevant covered agreement. In Malaysia's view, the alternative courses of conduct or alternative measures referred to by the Appellate Body were *dicta*, and, therefore, the Panel erred in interpreting these *dicta* as positive conditions for determining GATT-consistency.

2. The Chapeau of Article XX of the GATT 1994

16. Malaysia appeals certain of the Panel's conclusions under the chapeau of Article XX of the GATT 1994. In particular, Malaysia submits that the Panel erred in considering the obligation of the United States as an obligation to *negotiate*, as opposed to an obligation to *conclude* an international agreement.

17. Malaysia notes that the Appellate Body made pertinent observations and comments in its analysis of the chapeau of Article XX of the GATT 1994 with respect to "arbitrary or unjustifiable discrimination". In its treatment of "unjustifiable discrimination" the Appellate Body stated "[a]nother 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".¹⁸ In Malaysia's view, these remarks of the Appellate Body emphasize the need for the *conclusion* of an international agreement.

18. Malaysia submits that these remarks of the Appellate Body constitute *dicta*. The Panel misunderstood these remarks to mean that alternative actions, in particular a demonstration of prior good faith negotiation, would "insulate" a unilateral measure from being characterized as "unjustifiable discrimination". It is further submitted that in the context of the new measure, the Panel failed to examine whether, in the circumstances, the United States acted in a manner constituting "unjustifiable discrimination".

19. Malaysia further contends that if the conclusion of the Panel is allowed to stand, it will lead to the "incongruous" result that any WTO Member would be able to offer to negotiate in good faith an agreement incorporating its "unilaterally defined standards" before claiming that its measure is justified under the pertinent exceptions of Article XX of the GATT 1994. According to Malaysia, the conclusion of the Panel will thus lead to the result that if a WTO Member fails to *conclude* an

¹⁷Appellate Body Report, WT/DS70/AB/RW, adopted 4 August 2000.

¹⁸Appellate Body Report, *United States – Shrimp*, *supra*, footnote 3, para. 166.

agreement, it could still claim that its application of a unilateral measure does not constitute "unjustifiable discrimination".

20. In addition, Malaysia submits that the Panel erred in concluding that the Inter-American Convention for the Protection and Conservation of Sea Turtles (the "Inter-American Convention") can reasonably be considered as a benchmark of what can be achieved through multilateral negotiations in the field of protection and conservation. The Panel did not provide any reasoning for taking this view. The Appellate Body cited the Inter-American Convention merely as an "example" of efforts made by the United States to reach a multilateral solution in relation to the conservation of sea turtles. In no sense was that convention considered as a "legal standard" by the Appellate Body. Moreover, the Appellate Body stated that one of the obligations which the United States had to fulfill in order to avoid "unjustifiable discrimination" was to engage in serious efforts to negotiate in good faith *before* the enforcement of a "unilateral" import prohibition.

21. Malaysia submits that the Panel's legal interpretation is erroneous because the United States had not proven that the unilateral and non-consensual procedures of the import prohibition had been eliminated. On the contrary, the ongoing negotiations on the Memorandum of Understanding on the Conservation and Management of Marine Turtles and their Habitats of the Indian Ocean and South-East Asian Region (the "South-East Asian MOU") demonstrated that an alternative and less trade restrictive course of action for securing the legitimate goals of the United States measure, was available. The logical consequence of the above argument is that the negotiations are underway, and, therefore, the import prohibition should be lifted.

22. Malaysia also appeals the Panel's conclusions under the heading "[m]easures comparable in effectiveness to the United States measure". Malaysia submits that the Appellate Body spoke of measures comparable in effectiveness to the United States measures in the context of illustrating the difference between the design and the application of the original measure.¹⁹ The Appellate Body noted that while the design of the measure permitted certification of countries with measures comparable in effectiveness to United States measures, this was not the way in which the measure was applied in fact. The Panel misread this observation of the Appellate Body to mean that a measure requiring that exporting countries adopt regulatory programmes that are comparable in effectiveness to that of an importing country could not constitute "unjustifiable discrimination".

23. Malaysia contends that the Appellate Body did not accept the legitimacy of "comparable measures" – either implicitly or otherwise. Rather, it was merely describing the intended operation of

the original measure. This is evident, *inter alia*, from the fact that the term "comparable in effectiveness" is the language of the 1996 Guidelines, which implemented the original measure. The Appellate Body was in no way authorizing importing Members to impose unilateral measures conditioning market access on an exporting Member having measures "comparable in effectiveness" to their own measures. The Panel, therefore, erred in assuming that the new measure, which imposed this requirement of measures "comparable in effectiveness to the United States regulatory programme", could not constitute unjustifiable discrimination.

24. Malaysia also submits that the Panel erred in finding that the Revised Guidelines allowed for *flexibility*, as they take account of situations where sea turtles are not endangered by shrimp trawling. Malaysia submits that the Revised Guidelines address only the incidental capture of sea turtles in the course of shrimp trawl harvesting. Close scrutiny of the Revised Guidelines discloses that they do not address the fact that the same conditions do not prevail in Malaysia. Malaysia does not practise shrimp trawling and the incidental capture of sea turtles in Malaysian waters is due to fish trawling and not shrimp trawling. Thus the Revised Guidelines fail to take into account the specific conditions prevailing in Malaysia and they, therefore, violate the chapeau of Article XX of the GATT 1994.

25. Malaysia appeals the Panel's treatment of the decision of the United States Court of International Trade (the "CIT") in *Turtle Island Restoration Network, et al. v. Robert L. Mallett, et al.*²⁰ (the "Turtle Island case"). Malaysia is of the view that, in declining to consider this decision, the Panel erred in taking the view that municipal law is insulated from scrutiny by panels. Malaysia submits that had the Panel scrutinized the decision in the *Turtle Island* case, and assessed the likelihood and consequences of the Revised Guidelines being modified in the future, it would have found that the "unjustifiable discrimination" under the chapeau of Article XX of the GATT 1994 has not been eliminated.

26. Finally, Malaysia requests that the Appellate Body recommend that the import prohibition be lifted so as to give effect to the recommendations and rulings of the DSB as per the Appellate Body Report.

¹⁹Appellate Body Report, *United States – Shrimp*, *supra*, footnote 3, para. 163.

²⁰110 Fed. Supp. 2d 1005 (CIT, 2000).

B. *Arguments of the United States – Appellee*

1. Terms of Reference

27. The United States submits that Malaysia's argument that the Panel failed to apply the correct scope of review in accordance with Article 21.5 of the DSU is without merit. Malaysia's reliance in this regard on the Appellate Body Report in *Canada – Aircraft* (21.5) is misplaced. The issue in that appeal was whether the Panel's review was limited to issues considered in the original panel and Appellate Body proceedings. The Appellate Body found that the DSU imposed no such limitation. In the present case, however, the Panel's scope of review was fully consistent with the Appellate Body findings in *Canada – Aircraft* (21.5).

28. The United States observes that the Panel in this case quoted at length from the Appellate Body Report in *Canada – Aircraft* (21.5). The Panel then concluded that it was fully entitled to address *all* the claims of Malaysia under Article XI and Article XX of the GATT 1994, whether or not these claims, the arguments and the facts supporting them were made before the original panel and the Appellate Body proceedings.

29. The United States argues that Malaysia's argument is based solely on the Panel's use of the phrase "recommendations and rulings of the DSB". In the view of the United States, the Panel's use of the phrase "complied with the recommendations and rulings of the DSB", is entirely appropriate, and indicates no limitation in its scope of review. In the context of this case, the recommendations and rulings of the DSB are that the United States "bring its measure ... into conformity with the obligations of the United States under [the GATT 1994]". The GATT 1994 is the only covered agreement at issue in the dispute.

2. The Chapeau of Article XX of the GATT 1994

30. The United States submits that the Panel correctly found that the United States has remedied the aspect of discrimination relating to differences in efforts to negotiate a bilateral or multilateral agreement. In its previous ruling in *United States - Shrimp*, the Appellate Body found that certain aspects of the application of Section 609, in their "cumulative effect", amounted to unjustifiable discrimination between countries where the same conditions prevail. One of those aspects related to efforts to negotiate. The Appellate Body then cited, and relied upon, the factual findings of the original panel concerning the absence of serious efforts of the United States to negotiate a conservation agreement with the complaining WTO Members.

31. The United States contends that it has proceeded to remedy this aspect of unjustifiable discrimination identified by the Appellate Body. In particular, the United States has made substantial efforts to negotiate a sea turtle conservation agreement in the Indian Ocean and South-East Asia region. The Panel found that these efforts did remedy this aspect of unjustifiable discrimination.

32. The United States submits that Malaysia does not contest the core findings of the Panel, namely, that the United States has engaged in serious, good faith efforts to negotiate a sea turtle conservation agreement with the countries in the Indian Ocean and South-East Asia region. The Panel considered whether the United States had addressed the effort-to-negotiate aspect of "unjustifiable discrimination" identified by the Appellate Body, and properly found that the United States had indeed remedied this aspect of discrimination.

33. The United States submits that, instead of addressing the pertinent findings of the Panel, Malaysia makes a number of arguments that are either based on mischaracterization of the Panel Report, or that amount to a request for a reversal of the key findings of the Appellate Body Report in *United States – Shrimp*. Malaysia argues that the Panel found that "a demonstration of prior good faith negotiation would insulate a unilateral measure from being characterized as unjustifiable discrimination."²¹ In the United States view, this argument fails to take into account the context of the Panel's discussions of efforts to negotiate, and thus amounts to a mischaracterization of the findings of the Panel.

34. The United States submits that the discussions by the Appellate Body and the Panel concerning negotiations arise in the context of applying the Article XX chapeau to the specific facts of this case. The language of the chapeau of Article XX requires that the WTO Member imposing the measure demonstrates that a measure is not applied in a manner that constitutes a means of unjustifiable discrimination. In the view of the United States, no single aspect of the application of the measure can, as Malaysia puts it, "insulate" the measure from an examination of other aspects of alleged discrimination.

35. The United States contends that it has addressed the "unjustifiable discrimination" test of the chapeau by making the *prima facie* case that the United States measure does not result in unjustifiable discrimination between countries where the same conditions prevail. In particular, in the original panel and Appellate Body proceedings, the United States showed the absence of any "unjustifiable discrimination between countries where the same conditions prevail" by demonstrating

²¹Malaysia's appellant's submission, para. 3.11.

that it applies the import restrictions even-handedly with respect to all countries that engage in shrimp trawl fishing in waters inhabited by endangered sea turtles.

36. The United States notes Malaysia's argument that the Panel "erred" in concluding that the Inter-American Convention on sea turtle conservation "can reasonably be considered as a benchmark of what can be achieved through multilateral negotiations."²² The United States submits that Malaysia has cited the Panel Report out of context. The Panel properly considered the United States efforts to negotiate for the purpose of determining whether the United States had remedied this aspect of discrimination identified by the Appellate Body. In this context, the Panel examined the efforts to negotiate involved in concluding the Inter-American Convention, and compared them with the efforts made by the United States to negotiate a sea turtle conservation agreement for the Indian Ocean and South-East Asia region. It was only in this sense that the Panel considered the Inter-American Convention to be a "benchmark".

37. Regarding Malaysia's argument that the Panel erred in finding the United States measure to be consistent with the *WTO Agreement* because "the United States had not proven that the unilateral and non-consensual procedures of the import prohibition had been eliminated", the United States submits that this argument runs counter to the finding in the Appellate Body Report reaffirming that nothing in the text of Article XX requires the elimination of a measure simply by virtue of it being "unilateral".

38. The United States refers to Malaysia's argument that the Panel erred in finding the United States measure to be consistent with the *WTO Agreement* because the Indian Ocean and South-East Asia negotiations constitute an "alternative course of action for securing the legitimate goals of the United States measure which was less restrictive." According to the United States, this argument is based on the flawed premise that a WTO Member must exhaust all possibilities for achieving its goals in other ways. The *WTO Agreement* contains no such requirement, and the Appellate Body made no such finding.

39. The United States submits that the Panel was correct in finding that the United States had remedied the aspect of unjustifiable discrimination identified in the Appellate Body Report relating to flexibility and consideration of local conditions.

40. The Appellate Body found that the most conspicuous flaw in the application of Section 609 was an apparent requirement that all other exporting Members adopt essentially the same policy as

that applied to domestic shrimp trawlers of the United States. The Appellate Body noted that the statutory provisions of Section 609 do not, in themselves, require that other WTO Members adopt essentially the same policies and enforcement practices as the United States, but that the guidelines then in effect appeared to lack flexibility. The Appellate Body also found that the guidelines did not appear to allow for flexibility in the consideration of different conditions that may exist in different harvesting nations.

41. The United States argues that Malaysia does not take issue with the Panel's analysis of the language in the Revised Guidelines. In addition, Malaysia did not seek to test the flexibility of the guidelines in practice by seeking certification of the Malaysian programme for conserving sea turtles in shrimp trawl fisheries.

42. The United States refers to Malaysia's argument that the Revised Guidelines do not address Malaysia's claim that "Malaysia does not practise shrimp trawling and the incidental catch of sea turtles is due to fish trawling and not shrimp trawling."²³ According to the United States, this "vague, undeveloped argument" does not rebut the *prima facie* case that the revised United States guidelines do in fact allow for flexibility and consideration of local conditions.

43. In the view of the United States, Malaysia's argument that the Panel "erred in taking the view that the issue of municipal law is insulated from scrutiny by panels" mischaracterizes the Panel's findings, and is without merit. The Panel considered the record before it, and properly concluded that under the Revised Guidelines, the importation of shrimp harvested by vessels using TEDs is allowed, even if the exporting nation has not been certified pursuant to Section 609.

44. With respect to the *Turtle Island* case, the United States submits that Malaysia does not present any arguments as to why the Panel was incorrect in its reasoning with respect to the relevant domestic law. As the Panel noted, the domestic court expressly declined to order any change in the Revised Guidelines, and those provisions of the Revised Guidelines that allow the importation of TED-caught shrimp from non-certified countries remain in effect.

²²Malaysia's appellant's submission, para. 3.13.

²³Malaysia's appellant's submission, para. 3.21.

C. *Arguments of the Third Participants*

1. Australia

(a) Terms of Reference

45. Australia submits that, in accordance with the provisions of Article 21.5 of the DSU, a panel is required to examine the consistency with a covered agreement of measures taken to comply with the recommendations and rulings of the DSB. This requires the relevant panel to conduct a fresh factual and legal analysis of the revised or new measure.

46. It is Australia's view that the Panel in this case did not examine the measures taken to comply on that basis. Had it done so, Australia submits that the Panel would not have had sufficient grounds to arrive at the finding that Section 609 of Public Law 101-162, as implemented by the Revised Guidelines of 8 July 1999 and as applied so far by the United States authorities, is justified under Article XX of the GATT 1994.

(b) The Chapeau of Article XX of the GATT 1994

47. Australia argues that the Panel erred in its conclusion that engagement by the United States in good faith negotiations would, in itself, necessarily be sufficient to meet the requirement of the chapeau of Article XX that its measure not be applied in a manner involving unjustifiable discrimination. This approach is inconsistent with the text of the chapeau of Article XX, and misapplies the reasoning of the Appellate Body Report.

48. Australia is of the view that the Panel misconstrued the Appellate Body findings, and the requirements of the chapeau of Article XX, in concluding that the United States would be entitled to maintain the implementing measure if it were demonstrated that it was making serious, good faith efforts to conclude an international agreement on the protection and conservation of sea turtles. This interpretation would seriously impair the delicate balance of rights and obligations embodied in Article XX and open the door for WTO Members to justify unilaterally-imposed trade restrictions simply on the basis of simultaneous entry into international negotiations. Article XX does not proscribe unilateral trade restrictions, but a reasonable degree of limitation must be imposed on their use – in line with the wording of the chapeau – if the balance of rights and obligations is to be preserved.

49. Australia submits that it is for the United States to demonstrate what serious, good faith efforts it had undertaken to obviate or eliminate the unjustifiably discriminatory nature of the ban –

including in the design, extent and implementation of the measure. The progress of the Indian Ocean initiative has demonstrated the existence of a viable, non-discriminatory alternative to the unilateral import restriction. Given this progress, the United States has not established why its unilateral import restriction is no longer a form of unjustifiable discrimination.

50. Australia argues that the Panel did not ensure that the United States effectively met its burden of proof in seeking to justify its measure pursuant to Article XX. In particular, the United States did not prove that its measure was consistent with the requirements of the chapeau of Article XX. The fact that the United States did not present sufficient evidence to demonstrate that the measure was not a means of unjustifiable discrimination meant that the Panel could not have found that the United States measure met the requirements of the chapeau.

2. European Communities

(a) Terms of Reference

51. The European Communities submits that, given that measures taken to comply with the recommendations and rulings of the DSB are, by definition, new and different measures that may be inconsistent with provisions of the *WTO Agreement* that were not examined by the original panel, it is correct that a panel acting pursuant to Article 21.5 of the DSU will, as a consequence, have to address a new and different factual and legal situation.

52. However, the European Communities submits that all panels are bound by their terms of reference that are determined, pursuant to Article 7.1 of the DSU, by the "request for the establishment of a panel". The European Communities observes that, in its "request for the establishment of a panel", Malaysia referred only to the GATT 1994, and to the recommendations and rulings of the DSB. On the basis of Malaysia's "request for the establishment of a panel", and on its subsequent submissions, the Panel found that the claims of Malaysia are exclusively based on the findings of the Appellate Body and on non-compliance with them. Malaysia does not make any new claim under Article XX.

53. Given that the terms of reference of a panel "established" pursuant to Article 21.5 of the DSU are based on the same claims and legal bases as the terms of reference of the original panel, the Panel's treatment of Malaysia's complaint pursuant to Article 21.5 of the DSU does not appear to be in error. The Panel was not at liberty to examine other issues.

(b) The Chapeau of Article XX of the GATT 1994

54. The European Communities believes that international cooperation and negotiation must be preferred over unilateral action, particularly in the area of the protection of the environment, for all the reasons set out in the original Appellate Body Report. The European Communities emphasizes that international cooperation by its own nature is a process and not a result. Such cooperation is necessarily based on reciprocal efforts to resolve a common concern in the mutual interest.

55. Under the circumstances of the present case, it appears to the European Communities that international cooperation requires as a minimum the exchange of data and readily available scientific knowledge between all interested parties. Under the Revised Guidelines, the United States would admit Malaysian shrimp to the United States market provided that Malaysia shows, on the basis of relevant data, that either its turtle conservation programme is "comparable in effectiveness" to the conservation method chosen by the United States or, in the alternative, that such conservation methods are unnecessary under the conditions prevailing in the waters in which Malaysia's trawlers are operating. The United States is thus apparently seeking Malaysia's participation in international cooperation in the form of an exchange of available data.

56. The application of the new measure has become more flexible in comparison with the application of the original measure, and this is the basis for the Panel's finding that the contested United States measure is currently not in conflict with the prohibition of "unjustifiable discrimination" under the chapeau of Article XX of the GATT 1994.

57. With respect to the *Turtle Island* case, the European Communities submits that the Panel correctly concluded that it was not for it to second-guess the outcome of a domestic dispute on the correct interpretation of a United States statute where a certain interpretation had been chosen by a domestic court, and that interpretation was challenged by the United States administration on appeal in the domestic courts.

58. The European Communities contends that it flows from the findings of the Panel that the ruling of the domestic court did not oblige the United States to violate its WTO obligations under the circumstances of the present case, particularly because the ruling was not final and because requests for interim relief were rejected. This appears to be a correct reading of the situation under the domestic law of the United States. In particular, the Revised Guidelines continue to be fully applied and therefore represent the situation that prevails under United States law.

59. In conclusion, the European Communities reiterates its position before the Panel that the complaint by Malaysia in this case is somewhat premature. Malaysia has not yet applied for certification. It is, therefore, not yet clear how the contested legislation would apply to imports of shrimp and shrimp products from Malaysia.

3. Hong Kong, China

(a) Terms of Reference

60. Hong Kong, China recalls that in its submission to the Panel, it expressed the view that the issue before a panel acting pursuant to Article 21.5 of the DSU is whether a new measure is in itself consistent with the *WTO Agreement*, particularly with the specific provisions with which the original panel or Appellate Body found the original measure inconsistent.

61. In the view of Hong Kong, China, panels should limit their review to the new measure, that is the measure adopted after the original panel (or the Appellate Body, as the case may be) has pronounced on the WTO-inconsistency; examine the new measure's consistency with the *WTO Agreement*; and further, examine to what extent the WTO Member has adequately implemented the recommendations and rulings of the original panel or the Appellate Body in adopting the new measure.

62. With respect to the judgment of the CIT in the *Turtle Island* case, Hong Kong, China, notes that in the absence of a clear mandate given to international adjudicating bodies, they commonly interpret only international law and treat domestic law, whenever warranted, as a factual matter. The same approach seemed to have been adopted by the Panel in the present case. Accordingly, Hong Kong, China, is of the view that the Panel was not called upon to speculate on the results of the appeal of the CIT judgment and make a ruling on that basis. Further, Hong Kong, China is mindful that the CIT decision is under appeal and it could be upheld by the highest domestic United States court.

4. India

(a) Terms of Reference

63. India submits that, as the measures taken to comply with the recommendations and rulings of the DSB are, by definition, new and different measures, it is possible that the new implementing measures could be inconsistent with provisions of WTO covered agreements that were not examined by the original panel. Therefore, a panel "established" under Article 21.5 of the DSU would have to

address a new and different factual and legal situation. India, therefore, agrees with Malaysia that a correct reading of Article 21.5 of the DSU required the Panel to examine the alleged inconsistency also with regard to WTO provisions that were not relevant for the resolution of the dispute in the original proceedings.

64. With respect to the *Turtle Island* case, India agrees with Malaysia that the Panel erroneously refrained from examining municipal law by treating it as a fact. In order to evaluate the WTO-consistency of municipal law, the interpretation given by a domestic court is of prime importance. India also concurs with Malaysia that the United States bears responsibility for the actions of all branches of its government, including the judiciary. The CIT is a judicial organ of the United States. Its interpretation that Section 609 did not permit the import of TED-caught shrimp from non-certified countries should be treated as an authoritative interpretation of United States law. In the light of the Appellate Body's finding in *United States – Shrimp*, the Panel should have concluded that Section 609 was inconsistent with the chapeau of Article XX of the GATT 1994.

5. Japan

(a) The Chapeau of Article XX of the GATT 1994

65. Japan is of the view that as the provisions in Article XX of the GATT 1994 are "exceptions" to the basic principles of the GATT 1994, they should be applied in a strict manner. This applies especially when a unilateral measure is claimed to be justified under this Article.

66. Although Japan agrees with most of the conclusions reached by the Panel, it is Japan's view that the Panel Report does not describe in detail the reasoning or process by which the Panel reached those conclusions. Considering the importance attached to the requirements of the chapeau of Article XX as a tool for prevention of abuse, the chapeau of Article XX must be applied in a manner that fully accounts for the strict standard required of the "General Exceptions" under Article XX.

67. Malaysia's argument that negotiations are not alternative actions for the United States to rectify and address the problem of "arbitrary and unjustifiable discrimination" is based on an incorrect reading of the original Appellate Body Report. As the lack of serious good faith negotiation was one of the reasons for the Appellate Body finding of "arbitrary or unjustifiable discrimination", it seems logical to assume that by engaging in sufficiently "serious good faith" negotiations and meeting other requirements, the United States has addressed the "arbitrary or unjustifiable discrimination". Thus, Japan agrees with the Panel's finding that the United States was not under the obligation to conclude an agreement for the protection and conservation of sea turtles before taking the measure.

68. Japan submits however, that as the notion of "serious" and "good faith" is subjective in nature, a more objective test, such as a common recognition by other negotiating countries on the necessity of the measure in question, may be needed in addition to the criterion of "serious good faith efforts". Japan considers that the Panel should have included explicitly in its Report such a test of support for, or recognition of, the measure in question by other negotiating countries as a part of the negotiation requirement.

6. Mexico

(a) Terms of Reference

69. Mexico agrees with Malaysia that the terms of reference of a panel "established" pursuant to Article 21.5 of the DSU are to examine whether the measures taken to comply with the recommendations and rulings are consistent with the covered agreements, rather than with its own recommendations and rulings.

70. Mexico submits that the Panel in this case should have paid particular attention to the question whether the United States measure could be justified under Article XX of the GATT 1994 because it was 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. Mexico considers that the Panel should also have paid greater attention to the legal provisions themselves rather than to the Report of the Appellate Body which considered the original measure. In Mexico's view, it is not valid to argue that a WTO Member is authorized to adopt measures that would otherwise be inconsistent with Article XX of the GATT 1994, basing itself on an interpretation of Article XX limited to the circumstances and reasoning in a previous dispute settlement case.

7. Thailand

(a) Terms of Reference

71. Thailand is of the view that, in accordance with Article 21.5 of the DSU, the Panel was bound to evaluate the consistency of the "measures taken to comply" with the covered agreement concerned, which in the present case is the GATT 1994. Thailand agrees with the Panel that this was to be done in the light of the evaluation of the consistency of the original measure with a covered agreement undertaken by the original panel and subsequently by the Appellate Body.

72. However, Thailand's view differs from that of the Panel with respect to the scope of the "measures taken to comply" by the United States. Thailand disagrees with the approach of the Panel of examining only the consistency with the GATT 1994 of the Revised Guidelines, and disregarding Section 609.

73. Thailand submits that had the Panel examined the consistency of Section 609 as part of the United States implementing measure, the Panel would have found that, with regard to the import of TED-caught shrimp from non-certified countries, Section 609 is inconsistent with the chapeau of Article XX of GATT 1994, read in the light of the Appellate Body's finding in *United States – Shrimp*. To examine the consistency of Section 609 in this regard, had the Panel decided to do so, it would be necessary for the Panel to "seek a detailed understanding" of the legislation. As it is not for the Panel to interpret Section 609 itself, such understanding must be based on an authoritative interpretation of the legislation under the United States domestic legal system, at least in cases where authoritative interpretation is available.

74. Thailand argues that the fact that the Revised Guidelines have not been modified following the CIT judgment does not remove the current inconsistency of Section 609 with the GATT 1994. A breach of a treaty obligation does not necessarily involve an act of the executive branch. It can also involve an act of the legislature or the judiciary, or, as in this case, both of these branches of government.

III. Preliminary Procedural Matter

75. On 13 August 2001, we received a brief from the American Humane Society and Humane Society International (the "Humane Society brief"). This brief was also attached as an exhibit to the appellee's submission filed by the United States in this appeal.

76. As we have previously stated in our Report in *United States – Import Prohibition of Certain Shrimp and Shrimp Products ("United States – Shrimp")*, attaching a brief or other material to the submission of either an appellant or an 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.²⁴ In that Report, we stated further that it is for a participant in an appeal to determine for itself what to include in its submission.²⁵

²⁴Appellate Body Report, WT/DS58/AB/R, adopted 6 November 1998, para. 89.

²⁵*Ibid.*

77. At the oral hearing in this appeal, held on 4 September 2001, we asked the United States to clarify the extent to which it adopted the arguments set out in the Humane Society brief. The United States stated: "[t]hose are the independent views of that organization. We adopt them to the extent they are the same as ours but otherwise they are their independent views. We submit them for your consideration but not like our arguments where, for example, the panel is expected to address each one." Accordingly, we focus our attention on the legal arguments in the appellee's submission of the United States.

78. On 20 August 2001, we received a brief from Professor Robert Howse, a professor of international trade law at the University of Michigan Law School in Ann Arbor, Michigan, in the United States. In rendering our decision in this appeal, we have not found it necessary to take into account the brief submitted by Professor Howse.

IV. Issues Raised in this Appeal

79. The measure at issue in this dispute consists of three elements: Section 609 of the United States Public Law 101-162 ("Section 609"); the Revised Guidelines for the Implementation of Section 609 of Public Law 101-162 Relating to the Protection of Sea Turtles in Shrimp Trawl Fishing Operations (the "Revised Guidelines")²⁶; and the application of both Section 609 and the Revised Guidelines in the practice of the United States. Both the United States and Malaysia agree on this definition of the measure.²⁷ So does the Panel.²⁸ So do we.

²⁶United States Department of State, Federal Register Vol. 64, No. 130, 8 July 1999, Public Notice 3086, pp. 36946 – 36952. The Revised Guidelines are attached to the Panel Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products, Recourse to Article 21.5 of the DSU by Malaysia* (the "Panel Report"), WT/DS58/RW, 15 June 2001.

²⁷In response to our questions at the oral hearing, the United States submitted that:

The measure at issue in this appeal would be Section 609 as currently applied through the [United States] guidelines currently in effect.

In response to the same question, Malaysia stated that:

Malaysia's contention is that the measure at issue is the 1999 revised guidelines which are the guidelines to implement Section 609 and their application.

²⁸The Panel stated:

The "implementing measure" is composed of Section 609 of Public Law 101-162, of the revised guidelines pursuant to Section 609, dated 8 July 1999, Federal Register, Vol. 64, No. 130, Public Notice 3086, p. 36946 (hereafter the "Revised Guidelines"), as well as of any practice under those Revised Guidelines.

(Panel Report, footnote 154 to para. 5.1)

80. With respect to this measure, the following issues are raised in this appeal:

- (a) whether the Panel correctly fulfilled its mandate under Article 21.5 of the DSU of examining the consistency with the relevant provisions of the GATT 1994 of the United States measure that was taken to comply with the recommendations and rulings of the DSB in *United States – Shrimp*; and
- (b) whether the Panel erred in finding that the measure at issue is now applied in a manner that no longer constitutes a means of "arbitrary or unjustifiable discrimination between countries where the same conditions prevail" and is, therefore, within the scope of measures permitted under Article XX of the GATT 1994.²⁹

81. With respect to the measure at issue in this dispute, the United States has not appealed the conclusion of the Panel that the measure violates Article XI:1 of the GATT 1994.³⁰ Thus, we do not address that issue in this appeal.

82. Malaysia has not appealed the conclusion of the Panel that Section 609 is provisionally justified under subparagraph (g) of Article XX of the GATT 1994.³¹ Also, Malaysia confirmed at the oral hearing in this appeal that it has also not appealed the conclusion of the Panel that the measure at issue is not applied in a manner that constitutes "a disguised restriction on international trade" under the chapeau of Article XX of the GATT 1994.³² Thus, we do not address those issues in this appeal.

V. Terms of Reference

83. The first issue raised by Malaysia in this appeal is whether the Panel properly examined the United States measure taken to comply with the recommendations and rulings of the DSB in *United States – Shrimp*. Malaysia argues that the Panel improperly limited its analysis to the recommendations and rulings of the DSB, and thus failed to fulfill its mandate under Article 21.5 of the DSU because it did not examine the consistency of the United States implementing measure with

²⁹ Panel Report, para. 5.137.

³⁰ *Ibid.*, para. 5.23.

³¹ *Ibid.*, para. 5.42.

³² The Panel's findings on this issue are set out in paragraph 5.144 of the Panel Report. At the oral hearing, we noted that Malaysia had made no reference in its appellant's submission to the findings of the Panel with respect to whether the United States measure was applied in a manner that constitutes "a disguised restriction on international trade". We asked Malaysia to confirm that it was not appealing those findings. Malaysia did so.

the relevant provisions of the GATT 1994. Malaysia argues as well that the Panel erroneously based its analysis entirely on our Report in *United States – Shrimp*.

84. Malaysia's appeal on this point goes to the heart of what a panel is required to do in proceedings under Article 21.5 of the DSU, which states, in pertinent part:

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.

85. In *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU ("Canada – Aircraft (21.5)"*), we discussed one aspect of a panel's task under Article 21.5 of the DSU. In that case, the Panel declined to examine an argument by Brazil on the ground that the argument "did not form part" of the reasoning of the original panel and was "not relevant to the present dispute, which concerns the issue of whether or not Canada had implemented the DSB recommendation".³³ We disagreed with that ruling, and stated there that:

It follows then that the task of the Article 21.5 Panel in this case is, in fact, to determine whether the new measure – the revised TPC programme – is consistent with Article 3.1(a) of the *SCM Agreement*.

Accordingly, in carrying out its review under Article 21.5 of the DSU, a panel is not confined to examining the "measures taken to comply" from the perspective of the claims, arguments and factual circumstances that related to the measure that was the subject of the original proceedings. Although these may have some relevance in proceedings under Article 21.5 of the DSU, Article 21.5 proceedings involve, in principle, not the original measure, but rather a new and different measure which was not before the original panel. . . .³⁴

³³ Appellate Body Report, WT/DS70/AB/RW, adopted 4 August 2000, para. 39.

³⁴ *Ibid.*, paras. 40-41.

We stated further that:

Indeed, the utility of the review envisaged under Article 21.5 of the DSU would be seriously undermined if a panel were restricted to examining the new measure from the perspective of the claims, arguments and factual circumstances that related to the original measure, because an Article 21.5 panel would then be unable to examine fully the "consistency with a covered agreement of the measures taken to comply", as required by Article 21.5 of the DSU.³⁵

86. As we ruled in our Report in *Canada – Aircraft* (21.5), panel proceedings pursuant to Article 21.5 of the DSU involve, in principle, not the original measure, but a new and different measure that was not before the original panel. Therefore, "in carrying out its review under Article 21.5 of the DSU, a panel is not confined to examining the 'measure[] taken to comply' from the perspective of the claims, arguments and factual circumstances that related to the measure that was the subject of the original proceedings."³⁶

87. When the issue concerns the consistency of a new measure "taken to comply"³⁷, the task of a panel in a matter referred to it by the DSB for an Article 21.5 proceeding is to consider that new measure in its totality. The fulfilment of this task requires that a panel consider both the measure itself and the measure's application. As the title of Article 21 makes clear, the task of panels under Article 21.5 forms part of the process of the "*Surveillance of Implementation of the Recommendations and Rulings*" of the DSB. Toward that end, the task of a panel under Article 21.5 is to examine the "consistency with a covered agreement of measures taken to comply with the recommendations and rulings" of the DSB. That task is circumscribed by the specific claims made by the complainant when the matter is referred by the DSB for an Article 21.5 proceeding. It is not part of the task of a panel under Article 21.5 to address a claim that has not been made.

88. Malaysia relies in this appeal on our ruling in *Canada – Aircraft* (21.5). We understand Malaysia to argue, based in part on our ruling in *Canada – Aircraft* (21.5), that the Panel in this case had a duty to review the *totality* of the United States measure, and to assess it for its consistency with the relevant provisions of the GATT 1994. That is indeed a panel's task under Article 21.5 of the DSU. Yet, as we have said, it is not part of a panel's task to go beyond the particular claims that have been made with respect to the consistency of a new measure with a covered agreement when a matter is referred to it by the DSB for an Article 21.5 proceeding. Thus, it would not have been appropriate in this case for the Panel to address a claim that was *not* made by Malaysia when requesting that this matter be referred by the DSB for an Article 21.5 proceeding.

89. With respect to a claim that *has* been made when a matter is referred by the DSB for an Article 21.5 proceeding, Malaysia seems to suggest as well that a panel must re-examine, for WTO-consistency, even those aspects of a new measure that were part of a previous measure that was the subject of a dispute, and were found by the Appellate Body to be *WTO – consistent* in that dispute, and that remain unchanged as part of the new measure.

90. In considering this argument, we examine what the Panel did in this case in fulfilling its task under the DSU. As we have said, the Panel was required to review the new measure in its totality and in its application when examining the matter referred by the DSB for the Article 21.5 proceeding. In this case, the question whether it did or did not fulfil this requirement arises from the treatment by the Panel of a particular part of the new measure that was also part of the original measure in the original proceedings — Section 609.

91. Section 609 — a United States statute enacted by the United States Congress — is a common aspect of both the original measure at issue in the previous case and appeal, and the new measure at issue in this case and appeal. As Section 609 is part of the new measure, it is not immune from scrutiny under Article 21.5. However, it will be recalled that, in the previous case, we found that Section 609 was entitled to "provisional justification" under subparagraph (g) of Article XX of the GATT 1994. It will be recalled as well that, in the previous case, the deficiencies we found in the *application* of the original measure by the United States that denied that original measure the benefit of the exception provided by Article XX of the GATT 1994 were unrelated to Section 609 itself. Those deficiencies related to the original guidelines that were promulgated by the United States Department of State for the purpose of implementing Section 609, and to the practice of the United States in applying those original guidelines to WTO Members.

³⁵Appellate Body Report, WT/DS70/AB/RW, adopted 4 August 2000, para. 41.

³⁶*Ibid.*, para. 41.

³⁷As opposed to a debate on the "existence ... of measures taken to comply", which is not at issue here.

92. In its analysis of the consistency of Section 609 in this new case, the Panel stated that:

The Panel considers that two questions have to be addressed in order to determine whether the implementing measure meets the requirements of paragraph (g) of Article XX. First, the Panel notes that the Appellate Body found that Section 609 was "provisionally justified" under Article XX(g). We understand this to mean that, in the process of determining whether Section 609 was justified under Article XX, the Appellate Body concluded that Section 609 satisfied the first tier of the analysis defined in its report on *United States – Gasoline*, i.e. the *characterization* of the measure under Article XX(g). This implies that, as long as the implementing measure before us is identical to the measure examined by the Appellate Body in relation to paragraph (g), we should not reach a different conclusion from the Appellate Body.³⁸ (footnote omitted)

The Panel went on to conclude that:

... the United States did not amend Section 609, whereas it has issued revised implementing guidelines. We therefore conclude that since Section 609 as such has not been modified, the findings of the Appellate Body regarding paragraph (g) remain valid and the consistency of Section 609 as such with the requirements of paragraph (g) also remains valid, to the extent that the Revised Guidelines do not modify the *interpretation* to be given to Section 609 in that respect. We have no evidence that the Revised Guidelines have modified in any way the meaning of Section 609 *vis-à-vis* the requirements of paragraph (g), as interpreted by the Appellate Body.³⁹

93. We agree. It is not disputed that the wording of Section 609 has not been changed since the first case. The Congress of the United States has not amended the statute. In addition, the meaning of Section 609 has not been changed by the decision of the United States Court of International Trade (the "CIT") in *Turtle Island Restoration Network, et al. v. Robert L. Mallett, et al.* (the "*Turtle Island* case").⁴⁰

94. The CIT ruling in the *Turtle Island* case addressed the Revised Guidelines: that ruling made no change to the interpretation of Section 609. Moreover, as stated by the Panel, the ruling in the *Turtle Island* case is declaratory: the CIT has not ordered the United States Department of State to modify either the content or the interpretation of the Revised Guidelines; in the legal interpretation of the United States authorities entrusted with enforcing them, the Revised Guidelines remain the

³⁸Panel Report, para. 5.39.

³⁹Panel Report., para. 5.41.

⁴⁰110 Fed. Supp. 2d 1005 (CIT, 2000). See, Panel Report, para. 5.109.

same.⁴¹ Rightly, when examining the United States measure, the Panel took into account the status of municipal law at the time. In particular, the Panel took note of the fact that the CIT ruling in the *Turtle Island* case has not altered the content of the Revised Guidelines, and has not prevented the United States government from authorizing the importation of TED-caught shrimp from uncertified countries. In response to our questions at the oral hearing, the United States confirmed that the Department of State has received no order from the CIT to change its practice, and, therefore, the Department of State continues to apply the Revised Guidelines as before.⁴² Malaysia has not shown otherwise.

95. There is no way of knowing or predicting when or how that particular legal proceeding will conclude in the United States. The *Turtle Island* case has been appealed and could conceivably go as far as the Supreme Court of the United States.⁴³ It would have been an exercise in speculation on the part of the Panel to predict either when or how that case may be concluded, or to assume that injunctive relief ultimately would be granted and that the United States Court of Appeals or the Supreme Court of the United States eventually would compel the Department of State to modify the Revised Guidelines. The Panel was correct not to indulge in such speculation, which would have been contrary to the duty of the Panel, under Article 11 of the DSU, to make "an objective assessment of the matter ... including an objective assessment of the facts of the case".

96. As we see it, then, the Panel properly examined Section 609 as part of its examination of the totality of the new measure, correctly found that Section 609 had not been changed since the original proceedings, and rightly concluded that our ruling in *United States – Shrimp* with respect to the consistency of Section 609, therefore, still stands.

97. We wish to recall that panel proceedings under Article 21.5 of the DSU are, as the title of Article 21 states, part of the process of the "*Surveillance of Implementation of Recommendations and Rulings*" of the DSB. This includes Appellate Body Reports. To be sure, the right of WTO Members to have recourse to the DSU, including under Article 21.5, must be respected. Even so, it must also be kept in mind that Article 17.14 of the DSU provides not only that Reports of the Appellate Body

⁴¹Panel Report, para. 5.109.

⁴²The United States submitted that:

We do not believe that the court decision in the litigation changes the measure. The measure is the statute and the guidelines. There is litigation and controversy in the United States about what those guidelines might look like. However, for today and the foreseeable future, the guidelines stand. They are what governs. That is what happens at the ports.

(United States response to questioning at the oral hearing)

⁴³Panel Report, para. 5.109.

"shall be" adopted by the DSB, by consensus, but also that such Reports "shall be ... unconditionally accepted by the parties to the dispute. ..." Thus, Appellate Body Reports that are adopted by the DSB are, as Article 17.14 provides, "... unconditionally accepted by the parties to the dispute", and, therefore, must be treated by the parties to a particular dispute as a final resolution to that dispute. In this regard, we recall, too, that Article 3.3 of the DSU states that the "prompt settlement" of disputes "is essential to the effective functioning of the WTO".

98. Therefore, so far as the examination of the measure at issue in this appeal is concerned, the task of the Panel with respect to Section 609, as part of that new measure, was limited to examining its *application*. More specifically, the task of the Panel as it related to Section 609 was to decide whether Section 609 has been *applied* by the United States in a way that constitutes "arbitrary or unjustifiable discrimination between countries where the same conditions prevail" in violation of the chapeau of Article XX of the GATT 1994. Thus, given the structure of the new measure, the task of the Panel was to determine whether Section 609 has been *applied* by the United States, through the Revised Guidelines, either on their face, or in their application, in a manner that constitutes "arbitrary or unjustifiable discrimination".

99. This is precisely what the Panel did in this case. Therefore, we consider what the Panel did to be an appropriate fulfilment of its task under the DSU.

100. Malaysia argues with respect to the terms of reference that the Panel confined itself inappropriately to an examination of whether the new measure complied with the rulings and recommendations of the DSB, and, more specifically, with the rulings of the Appellate Body that were adopted by the DSB in the previous case relating to the original measure. In support of this argument, Malaysia quotes various selected passages from the Panel Report.⁴⁴

⁴⁴Malaysia's appellant's submission, para. 3.2. Malaysia refers to footnote 211 of paragraph 5.66 and paragraphs 5.116, 5.120, 5.125 and 5.134 of the Panel Report.

101. In our view, a reading of the Panel Report as a whole does not provide support for Malaysia's contention. Indeed, the Panel appears to have done precisely the opposite of what Malaysia asserts. For example, we note that, in identifying its terms of reference, the Panel explicitly quoted the terms of Article 21.5 of the DSU⁴⁵ as well as our Report in *Canada – Aircraft* (21.5).⁴⁶

102. The Panel then stated:

The terms of reference of this Panel do not differ from the standard terms of reference applied in other Article 21.5 cases. In light of the reasoning of the Appellate Body mentioned above, the Panel considers that it is fully entitled to address all the claims of Malaysia under Article XI and Article XX of the GATT 1994, whether or not these claims, the arguments and the facts supporting them were made before the Original Panel and in the Appellate Body proceedings provided, as recalled by the panel on *Australia – Measures Affecting Importation of Salmon – Recourse by Canada to Article 21.5 of the DSU*, that the claims are identified in the request for referring the matter to a panel under Article 21.5 of the DSU.⁴⁷ (footnotes omitted)

⁴⁵Panel Report, para. 5.7.

⁴⁶*Ibid.*, para. 5.8. After quoting our Report in *Canada – Aircraft* (21.5), the Panel concluded that:

In light of the reasoning of the Appellate Body [in *Canada – Aircraft* (21.5)], the Panel considers that it is fully entitled to address all the claims of Malaysia under Article XI and Article XX of the GATT 1994, whether or not these claims, the arguments and the facts supporting them were made before the Original Panel and in the Appellate Body proceedings

(*Ibid.*, para. 5.9)

We agree with the Panel. However, we do not agree with Malaysia's reading of our Report in *Canada – Aircraft* (21.5). As the United States submits: "[t]he issue in *Canada Aircraft* was whether the Article 21.5 Panel's review was limited to issues considered in the original panel and Appellate Body proceedings, and the Appellate Body found that the DSU provides no such limitation". (footnote omitted) (United States appellee's submission, para. 11) With respect to this case, the United States notes: "[t]he Panel's report makes no limitations on its consideration of Malaysia's arguments". (United States appellee's submission, para.13) On this, we agree with the United States. The Panel in this case examined all of Malaysia's arguments, and did not decline to consider an argument on its merits on the ground that such argument had not been raised before the original panel or the Appellate Body.

⁴⁷Panel Report, para. 5.9.

103. Furthermore, in its analysis, the Panel examined Malaysia's claim that the new measure taken by the United States continued to violate Article XI:1 of the GATT 1994, and stated as follows:

The Panel notes that the elements of the original measure found to be incompatible with Article XI:1 in the Original Panel Report are still part of the implementing measure, i.e. Section 609 as currently applied by the United States. In particular, the United States continues to apply an import prohibition on shrimp and shrimp products harvested in a manner determined to be harmful to sea turtles. We note that the United States does not contest the fact that it applies such a prohibition of import. We consider that the prohibition at issue falls within the "prohibitions or restrictions, other than duties, taxes or other charges" maintained by a Member on the importation of a product from another Member, in contravention of Article XI:1.

The Panel therefore concludes that the measure taken by the United States to comply with the recommendations and rulings of the DSB in this case *violates Article XI:1 of the GATT 1994.*⁴⁸ (emphasis added)

104. The Panel then examined the provisional justification under Article XX(g) of the GATT 1994 of Section 609, which it had correctly found to be unchanged, in the following terms:

As a result, when considering the arguments of the United States, we shall first determine the consistency of the implementing measure under paragraph (g) of Article XX. If we find the implementing measure to be "provisionally justified" under paragraph (g), we shall proceed to determine whether it is applied in *conformity with the chapeau of Article XX.*⁴⁹ (emphasis added)

...

We therefore conclude that the implementing measure is provisionally justified *under paragraph (g) of Article XX.* We proceed with the second tier of the method applied by the Appellate Body in this case, i.e. the "further appraisal of the same measure under the introductory clause of Article XX."⁵⁰ (emphasis added, footnote omitted)

105. This analysis shows clearly that the Panel properly understood the scope of its mandate. Furthermore, the Panel's examination of whether the measure applied by the United States constitutes a "disguised restriction on international trade" under the chapeau of Article XX of the GATT 1994 demonstrates that the Panel understood very well the scope of its mandate. The Panel stated:

⁴⁸Panel Report, paras. 5.22-5.23.

⁴⁹*Ibid.*, para. 5.28.

⁵⁰*Ibid.*, para. 5.42.

The Panel notes that it is instructed by Article 21.5 of the DSU to review "the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings" of the DSB. The fact that the Appellate Body did not have to make a finding that the original measure was a disguised restriction on trade does not mean that the measure adopted to implement the DSB recommendations and rulings is not a disguised restriction on trade. The Panel also recalls that, as the party invoking Article XX, the United States bears the burden of proving that its implementing measure meets *all* the relevant requirements of the chapeau. This implies that the United States make a *prima facie* case that the implementing measure is not a disguised restriction on trade.⁵¹

106. Thus, the Panel examined the measure in the light of the relevant provisions of the GATT 1994, and, in doing so, made numerous references both to whether a violation of the GATT 1994 had occurred and to whether such a violation was nonetheless justified under Article XX. Accordingly, in reading the Panel Report as a whole, we find no support for Malaysia's argument that the Panel examined the new measure applied by the United States *only* in the light of the recommendations and rulings of the DSB.

107. Malaysia also objects to the frequent references made by the Panel to our reasoning in our Report in *United States – Shrimp*. The reasoning in our Report in *United States – Shrimp* on which the Panel relied was not *dicta*; it was essential to our ruling. The Panel was right to use it, and right to rely on it. Nor are we surprised that the Panel made frequent references to our Report in *United States – Shrimp*. Indeed, we would have expected the Panel to do so. The Panel had, necessarily, to consider our views on this subject, as we had overruled certain aspects of the findings of the original panel on this issue and, more important, had provided interpretative guidance for future panels, such as the Panel in this case.

108. In this respect, we note that in our Report in *Japan – Taxes on Alcoholic Beverages*, we stated that:

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.⁵²

109. This reasoning applies to adopted Appellate Body Reports as well. Thus, in taking into account the reasoning in an adopted Appellate Body Report — a Report, moreover, that was directly

⁵¹Panel Report, para. 5.138.

relevant to the Panel's disposition of the issues before it — the Panel did not err. The Panel was correct in using our findings as a tool for its own reasoning. Further, we see no indication that, in doing so, the Panel limited itself merely to examining the new measure from the perspective of the recommendations and rulings of the DSB.

110. We find, therefore, that the Panel correctly fulfilled its mandate under Article 21.5 of the DSU of examining the consistency, with the relevant provisions of the GATT 1994, of the United States measure taken to comply with the recommendations and rulings of the DSB in *United States – Shrimp*.

VI. The Chapeau of Article XX of the GATT 1994

111. The second issue raised in this appeal is whether the Panel erred in finding that the new measure at issue is applied in a manner that no longer constitutes a means of "arbitrary or unjustifiable discrimination between countries where the same conditions prevail" and is, therefore, within the scope of measures permitted under Article XX of the GATT 1994.⁵³

112. In its Notice of Appeal, Malaysia appeals the finding of the Panel that "Section 609 of Public Law 101-162, as implemented by the Revised Guidelines of 8 July 1999 and as applied so far by the [United States] authorities, is justified under Article XX of the GATT 1994 as long as the conditions stated in the findings of this Report, in particular the ongoing serious, good faith efforts to reach a multilateral agreement, remain satisfied."⁵⁴ In its appellant's submission, Malaysia has put forward six points of disagreement with respect to the reasoning and findings of the Panel that lead Malaysia to conclude that, despite the changes made by the United States to the original measure, elements of "arbitrary or unjustifiable discrimination" still remain in the manner in which the new measure is applied by the United States.

113. Malaysia argues that:

- the Panel erred in interpreting our previous ruling in *United States – Shrimp* as imposing upon the United States an obligation to *negotiate* rather than an obligation to *conclude* an international agreement⁵⁵;
- the Panel's finding results in "the absurd situation where any WTO Member would be able to offer to negotiate in good faith on an agreement incorporating its unilaterally defined standards before claiming that its measure is justified under Article XX of the GATT 1994 and in the event of failure to conclude an agreement, claim that the measure applying the unilateral standards could not constitute unjustifiable discrimination"⁵⁶;
- the Panel erred in concluding that the Inter-American Convention can reasonably be regarded as a "benchmark" of what can be achieved through multilateral negotiations in the field of protection and conservation⁵⁷;
- the Panel misconstrued the usage of the term "measures comparable in effectiveness to United States measures" by the Appellate Body to mean that the Appellate Body accepted the legitimacy of such "comparable measures"⁵⁸;
- the Panel erred in concluding that the Revised Guidelines are sufficiently flexible, even though the Revised Guidelines do not provide explicitly for the particular conditions prevailing in Malaysia⁵⁹; and
- the Panel erred in its treatment of the CIT ruling in the *Turtle Island* case and, thus, in its conclusion about the legal validity of those portions of the Revised Guidelines that permit the importation of TED-caught shrimp from non-certified harvesting countries.⁶⁰

⁵²Appellate Body Report, ("*Japan – Alcoholic Beverages*"), WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97, at 108.

⁵³Panel Report, para. 5.137.

⁵⁴*Ibid.*, para. 6.1.

⁵⁵Malaysia's appellant's submission, para 3.10(b)(i).

⁵⁶Executive summary of Malaysia's appellant's submission, para. 2(b)(ii).

⁵⁷Malaysia's appellant's submission, para 3.13.

⁵⁸*Ibid.*, paras. 3.17-3.18. See also, Executive summary of Malaysia's appellant's submission, para. 2(iv);

⁵⁹Malaysia's appellant's submission, paras. 3.20-3.21.

⁶⁰*Ibid.*, paras. 3.22-3.25.

114. Malaysia's first three arguments relate to the nature and extent of the duty of the United States to pursue international cooperation in protecting and conserving endangered sea turtles. Malaysia's last three arguments relate to the flexibility of the Revised Guidelines. Our analysis will address each of these arguments made by Malaysia.

A. *The Nature and the Extent of the Duty of the United States to Pursue International Cooperation in the Protection and Conservation of Sea Turtles*

115. Before the Panel, Malaysia asserted that the United States should have negotiated and *concluded* an international agreement on the protection and conservation of sea turtles before imposing an import prohibition. Malaysia argued that "by continuing to apply a unilateral measure after the end of the reasonable period of time pending the conclusion of an international agreement, the United States failed to comply with its obligations under the GATT 1994".⁶¹ The United States replied that it had in fact made serious, good faith efforts to negotiate and *conclude* a multilateral sea turtle conservation agreement that would include both Malaysia and the United States, and that these efforts, as detailed and documented before the Panel, should, in view of our previous ruling, be seen as sufficient to meet the requirements of the chapeau of Article XX. The Panel found as follows:

... The Panel first recalls that the Appellate Body considered "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" bears heavily in any appraisal of justifiable or unjustifiable discrimination within the meaning of the chapeau of Article XX. From the terms used, it appears to us that the Appellate Body had in mind a negotiation, not the conclusion of an agreement. If the Appellate Body had considered that an agreement had to be concluded before any measure can be taken by the United States, it would not have used the terms "with the objective"; it would have simply stated that an agreement had to be concluded.

...

⁶¹Panel Report, para. 5.1.

We are consequently of the view that the Appellate Body could not have meant in its findings that the United States had the obligation to conclude an agreement on the protection and conservation of sea turtles in order to comply with Article XX. However, we reach the conclusion that the United States has an obligation to make serious good faith efforts to reach an agreement before resorting to the type of unilateral measure currently in place. We also consider that those efforts cannot be a "one-off" exercise. There must be a continuous process, including once a unilateral measure has been adopted pending the conclusion of an agreement. Indeed, we consider the reference of the Appellate Body to a number of international agreements promoting a multilateral solution to the conservation concerns subject to Section 609 to be evidence that a multilateral, ideally non-trade restrictive, solution is generally to be preferred when dealing with those concerns, in particular if it is established that it constitutes "an alternative course of action reasonably open".

...

We understand the Appellate Body findings as meaning that the United States has an obligation to make serious good faith efforts to address the question of the protection and conservation of sea turtles at the international level. We are mindful of the potentially subjective nature of the notion of serious good faith efforts and of how difficult such a test may be to apply in reality.⁶² (footnotes omitted)

116. Malaysia appeals these findings of the Panel. According to Malaysia, demonstrating serious, good faith efforts to *negotiate* an international agreement for the protection and conservation of sea turtles is not sufficient to meet the requirements of the chapeau of Article XX.⁶³ Malaysia maintains that the chapeau requires instead the *conclusion* of such an international agreement. As Malaysia sees it, the "pertinent observations and comments" that we made in *United States – Shrimp* that could be construed to suggest otherwise "constitute dicta" in our previous Report.⁶⁴ On this basis, Malaysia argues that the Panel used that Report improperly in attempting to justify its reasoning that serious, good faith efforts alone would be enough to meet the requirements of the chapeau.⁶⁵ Further, Malaysia submits that the Panel misread our Report with respect to the Inter-American Convention, and, consequently, did not use that Convention properly in its analysis.⁶⁶

⁶²Panel Report, paras. 5.63, 5.67 and 5.76.

⁶³Malaysia's appellant's submission, para. 3.11.

⁶⁴*Ibid.*, paras. 3.10-3.11.

⁶⁵*Ibid.*, para. 3.11.

⁶⁶*Ibid.*, para. 3.13.

117. The chapeau of Article XX states:

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

118. The chapeau of Article XX establishes three standards regarding the *application* of measures for which justification under Article XX may be sought: first, there must be no "arbitrary" discrimination between countries where the same conditions prevail; second, there must be no "unjustifiable" discrimination between countries where the same conditions prevail; and, third, there must be no "disguised restriction on international trade".⁶⁷ The Panel's findings appealed by Malaysia concern the first and second of these three standards.⁶⁸

119. It is clear from the language of the chapeau that these two standards operate to prevent a Member from applying a measure provisionally justified under a sub-paragraph of Article XX in a manner that would result in "arbitrary or unjustifiable discrimination".⁶⁹ In *United States – Shrimp*, we stated that the measure at issue there resulted in "unjustifiable discrimination", in part because, as applied, the United States treated WTO Members differently. The United States had adopted a cooperative approach with WTO Members from the Caribbean/Western Atlantic region, with whom it had concluded a multilateral agreement on the protection and conservation of sea turtles, namely the Inter-American Convention. Yet the United States had not, we found, pursued the negotiation of such a multilateral agreement with other exporting Members, including Malaysia and the other complaining WTO Members in that case.

⁶⁷Appellate Body Report, *United States – Shrimp*, *supra*, footnote 24, para. 150; Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline ("United States – Gasoline")*, WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:1, 3, at 21-22.

⁶⁸The Panel also made findings regarding disguised restriction on trade but these are not appealed. Panel Report, paras. 5.138-5.144.

⁶⁹Appellate Body Report, *United States – Shrimp*, *supra*, footnote 24, paras. 156 and 160; Appellate Body Report, *United States – Gasoline*, *supra*, footnote 67 at 21-22.

120. Moreover, we observed there that Section 609, which was part of that original measure and remains part of the new measure at issue here, calls upon the United States Secretary of State 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 commercial fishing operations ... for the purpose of entering into bilateral and multilateral treaties with such countries to protect such species of sea turtles."⁷⁰ We concluded in that appeal that the United States had failed to comply with this statutory requirement in Section 609.

121. As we pointed out there:

Apart from the negotiation of the Inter-American Convention for the Protection and Conservation of Sea Turtles ... which concluded in 1996, the record before the Panel does not indicate any serious, substantial efforts to carry out these express directions of Congress.⁷¹ (footnotes omitted)

We also stated:

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.⁷²

122. We concluded in *United States – Shrimp* that, to avoid "arbitrary or unjustifiable discrimination", the United States had to provide all exporting countries "similar opportunities to negotiate" an international agreement. Given the specific mandate contained in Section 609, and given the decided preference for multilateral approaches voiced by WTO Members and others in the international community in various international agreements for the protection and conservation of endangered sea turtles that were cited in our previous Report, the United States, in our view, would be expected to make good faith efforts to reach international agreements that are comparable from one forum of negotiation to the other. The negotiations need not be identical. Indeed, no two negotiations

⁷⁰Section 609(a). See also, Appellate Body Report, *United States – Shrimp*, *supra*, footnote 24, para. 167.

⁷¹Appellate Body Report, *supra*, footnote 24, para. 167.

⁷²*Ibid.*, para. 172.

can ever be identical, or lead to identical results. Yet the negotiations must be *comparable* in the sense that comparable efforts are made, comparable resources are invested, and comparable energies are devoted to securing an international agreement. So long as such comparable efforts are made, it is more likely that "arbitrary or unjustifiable discrimination" will be avoided between countries where an importing Member concludes an agreement with one group of countries, but fails to do so with another group of countries.

123. Under the chapeau of Article XX, an importing Member may not treat its trading partners in a manner that would constitute "arbitrary or unjustifiable discrimination". With respect to this measure, the United States could conceivably respect this obligation, and the conclusion of an international agreement might nevertheless not be possible despite the serious, good faith efforts of the United States. Requiring that a multilateral agreement be *concluded* by the United States in order to avoid "arbitrary or unjustifiable discrimination" in applying its measure would mean that any country party to the negotiations with the United States, whether a WTO Member or not, would have, in effect, a veto over whether the United States could fulfill its WTO obligations. Such a requirement would not be reasonable. For a variety of reasons, it may be possible to conclude an agreement with one group of countries but not another. The conclusion of a multilateral agreement requires the cooperation and commitment of many countries. In our view, the United States cannot be held to have engaged in "arbitrary or unjustifiable discrimination" under Article XX solely because one international negotiation resulted in an agreement while another did not.

124. As we stated in *United States – Shrimp*, "the protection and conservation of highly migratory species of sea turtles ... demands concerted and cooperative efforts on the part of the many countries whose waters are traversed in the course of recurrent sea turtle migrations".⁷³ Further, 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".⁷⁴ For example, Principle 12 of the Rio Declaration on Environment and Development states, in part, that "[e]nvironmental measures addressing transboundary or global environmental problems should, as far as possible, be based on international consensus".⁷⁵ Clearly, and "as far as possible", a multilateral approach is

strongly preferred. Yet it is one thing to *prefer* a multilateral approach in the application of a measure that is provisionally justified under one of the subparagraphs of Article XX of the GATT 1994; it is another to require the *conclusion* of a multilateral agreement as a condition of avoiding "arbitrary or unjustifiable discrimination" under the chapeau of Article XX. We see, in this case, no such requirement.

125. Malaysia also disagrees with certain statements made by the Panel with respect to the Inter-American Convention. The Panel found that:

With respect to the absence of or insufficient negotiation with some Members compared with others, the reference of the Appellate Body to the Inter-American Convention is evidence that the efforts made by the United States to negotiate with the complainants before imposing the original measure were largely insufficient. The Inter-American Convention was negotiated as a binding agreement and has entered into force on 2 May 2001. We conclude that the Inter-American Convention can reasonably be considered as a benchmark of what can be achieved through multilateral negotiations in the field of protection and conservation. While we agree that factual circumstances may influence the duration of the process or the end result, we consider that any effort alleged to be a "serious good faith effort" must be assessed against the efforts made in relation to the conclusion of the Inter-American Convention.⁷⁶

126. Malaysia maintains that the word "benchmark", as used by the Panel, has the connotation of a "legal standard", and asserts that nothing in the Appellate Body Report in *United States – Shrimp* suggests that the Inter-American Convention has the status of a legal standard.⁷⁷ Malaysia sees a distinction between a "benchmark", which would have the value of a "legal standard", and an "example", which would not have such a value.⁷⁸

127. It should be recalled how we viewed the Inter-American Convention in *United States – Shrimp*. We stated there:

⁷³Appellate Body Report, *supra*, footnote 24, para. 168.

⁷⁴*Ibid.*

⁷⁵*Ibid.*

⁷⁶Panel Report, para. 5.71.

⁷⁷Malaysia's appellant's submission, para. 3.13.

⁷⁸*Ibid.*

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 before imposing the import ban.⁷⁹

128. Thus, in the previous case, in examining the original measure, we relied on the Inter-American Convention in two ways. First, we used the Inter-American Convention to show that "consensual and multilateral procedures are available and feasible for the establishment of programmes for the conservation of sea turtles".⁸⁰ In other words, we saw the Inter-American Convention as evidence that an alternative course of action based on cooperation and consensus was reasonably open to the United States. Second, we used the Inter-American Convention to show the existence of "unjustifiable discrimination". The Inter-American Convention was the result of serious, good faith efforts to negotiate a regional agreement on the protection and conservation of turtles, including efforts made by the United States. In the original proceedings, we saw a clear contrast between the efforts made by the United States to conclude the Inter-American Convention and the absence of serious efforts on the part of the United States to negotiate other similar agreements with other WTO Members. We concluded there that such a disparity in efforts to negotiate an international agreement amounted to "unjustifiable discrimination".⁸¹

129. With this in mind, we examine what the Panel did here. In its analysis of the Inter-American Convention in the context of Malaysia's argument on "unjustifiable discrimination", the Panel relied on our original Report to state that "the Inter-American Convention is evidence that the efforts made by the United States to negotiate with the complainants before imposing the original measure were largely insufficient".⁸² The Panel went on to say that "the Inter-American Convention can reasonably

be considered as a benchmark of what can be achieved through multilateral negotiations in the field of protection and conservation."⁸³

130. At no time in *United States – Shrimp* did we refer to the Inter-American Convention as a "benchmark". The Panel might have chosen another and better word — perhaps, as suggested by Malaysia, "example".⁸⁴ Yet it seems to us that the Panel did all that it should have done with respect to the Inter-American Convention, and did so consistently with our approach in *United States – Shrimp*. The Panel compared the efforts of the United States to negotiate the Inter-American Convention with one group of exporting WTO Members with the efforts made by the United States to negotiate a similar agreement with another group of exporting WTO Members. The Panel rightly used the Inter-American Convention as a factual reference in this exercise of comparison. It was all the more relevant to do so given that the Inter-American Convention was the only international agreement that the Panel could have used in such a comparison. As we read the Panel Report, it is clear to us that the Panel attached a relative value to the Inter-American Convention in making this comparison, but did not view the Inter-American Convention in any way as an absolute standard. Thus, we disagree with Malaysia's submission that the Panel raised the Inter-American Convention to the rank of a "legal standard". The mere use by the Panel of the Inter-American Convention *as a basis for a comparison* did not transform the Inter-American Convention into a "legal standard". Furthermore, although the Panel could have chosen a more appropriate word than "benchmark" to express its views, Malaysia is mistaken in equating the mere use of the word "benchmark", as it was used by the Panel, with the establishment of a legal standard.

131. The Panel noted that while "factual circumstances may influence the duration of the process or the end result, ... any effort alleged to be a 'serious good faith effort' must be assessed against the efforts made in relation to the conclusion of the Inter-American Convention".⁸⁵ Such a comparison is a central element of the exercise to determine whether there is "unjustifiable discrimination". The Panel then analyzed the negotiation process in the Indian Ocean and South-East Asia region to determine whether the efforts made by the United States in those negotiations were serious, good faith efforts comparable to those made in relation with the Inter-American Convention. In conducting this analysis, the Panel referred to the following elements:

⁷⁹Appellate Body Report, *supra*, footnote 24, para. 171.

⁸⁰*Ibid.*, para. 170.

⁸¹*Ibid.*, para. 172.

⁸²Panel Report, para. 5.71.

⁸³Panel Report, para. 5.71.

⁸⁴Malaysia's appellant's submission, para. 3.13.

⁸⁵Panel Report, para. 5.71.

- A document communicated on 14 October 1998 by the United States Department of State to a number of countries of the Indian Ocean and the South-East Asia region. This document contained possible elements of a regional convention on sea turtles in this region.⁸⁶
- The contribution of the United States to a symposium held in Sabah on 15-17 July 1999. The Sabah Symposium led to the adoption of a Declaration calling for the negotiation and implementation of a regional agreement throughout the Indian Ocean and South-East Asia region.⁸⁷
- The Perth Conference in October 1999, where participating governments, including the United States, committed themselves to developing an international agreement on sea turtles for the Indian Ocean and South-East Asia region.⁸⁸
- The contribution of the United States to the Kuantan round of negotiations, 11-14 July 2000. This first round of negotiations towards the conclusion of a regional agreement resulted in the adoption of the Memorandum of Understanding on the Conservation and Management of Marine Turtles and their Habitats of the Indian Ocean and South-East Asia (the "South-East Asian MOU"). The Final Act of the Kuantan meeting provided that before the South-East Asian MOU can be finalized, a Conservation and Management Plan must be negotiated and annexed to the South-East Asian MOU.⁸⁹ At the time of the Panel proceedings, the Conservation and Management Plan was still being drafted.⁹⁰

132. On this basis and, in particular, on the basis of the "contribution of the United States to the steps that led to the Kuantan meeting and its contribution to the Kuantan meeting itself"⁹¹, the Panel concluded that the United States had made serious, good faith efforts that met the "standard set by the Inter-American Convention."⁹² In the view of the Panel, whether or not the South-East Asian MOU is a legally binding document does not affect this comparative assessment because differences in

⁸⁶Panel Report, para. 5.79.

⁸⁷*Ibid.*

⁸⁸*Ibid.*

⁸⁹*Ibid.*, para. 5.81.

⁹⁰*Ibid.*, para. 5.84.

⁹¹*Ibid.*, para. 5.82.

⁹²*Ibid.*

"factual circumstances have to be kept in mind".⁹³ Furthermore, the Panel did not consider as decisive the fact that the final agreement in the Indian Ocean and South-East Asia region, unlike the Inter-American Convention, had not been concluded at the time of the Panel proceedings. According to the Panel, "at least until the Conservation and Management Plan to be attached to the MOU is completed, the United States efforts should be judged on the basis of its active participation and its financial support to the negotiations, as well as on the basis of its previous efforts since 1998, having regard to the likelihood of a conclusion of the negotiations in the course of 2001."⁹⁴

133. We note that the Panel stated that "any effort alleged to be a 'serious good faith effort' must be assessed against the efforts made in relation to the conclusion of the Inter-American Convention."⁹⁵ In our view, in assessing the serious, good faith efforts made by the United States, the Panel did not err in using the Inter-American Convention as an *example*. In our view, also, the Panel was correct in proceeding then to an analysis broadly in line with this principle and, ultimately, was correct as well in concluding that the efforts made by the United States in the Indian Ocean and South-East Asia region constitute serious, good faith efforts comparable to those that led to the conclusion of the Inter-American Convention. We find no fault with this analysis.⁹⁶

134. In sum, Malaysia is incorrect in its contention that avoiding "arbitrary and unjustifiable discrimination" under the chapeau of Article XX requires the *conclusion* of an international agreement on the protection and conservation of sea turtles. Therefore, we uphold the Panel's finding that, in view of the serious, good faith efforts made by the United States to negotiate an international

⁹³Panel Report. It appears that the United States was in favour of a legally binding agreement for the Indian Ocean and South-East Asia region, but a number of other parties were not, and the latter view prevailed. See, Panel Report, para. 5.83.

⁹⁴Panel Report, para. 5.84.

⁹⁵*Ibid.*, para. 5.71.

⁹⁶We note that a multilateral conference on sea turtles was held in Manila and resulted in the adoption of the Conservation and Management Plan to be annexed to the South-East Asian MOU. We also note that the South-East Asian MOU came into effect on 1 September 2001. To our mind, these events only reinforce the finding of the Panel that the efforts made by the United States to negotiate an international agreement in the Indian Ocean and South-East Asia region constitute serious, good faith efforts comparable to those made in relation to the Inter-American Convention. The Inter-American Convention, in Article IV.2(h), provides for the use of TEDs to reduce the incidental capture and mortality of sea turtles in the course of fishing activities. Objective 1.4 of the Conservation and Management Plan attached to the South-East Asian MOU requires signatory states to "[r]educe to the greatest extent practicable the incidental capture and mortality of marine turtles in the course of fishing activities". In this respect, signatory states are directed to "[d]evelop and use gear, devices and techniques to minimise incidental capture of marine turtles in fisheries, such as devices that effectively allow the escape of marine turtles, and spatial and seasonal closures".

agreement, "Section 609 is now applied in a manner that no longer constitutes a means of unjustifiable or arbitrary discrimination, as identified by the Appellate Body in its Report".⁹⁷

B. *The Flexibility of the Revised Guidelines*

135. We now turn to Malaysia's arguments relating to the flexibility of the Revised Guidelines. Malaysia argued before the Panel that the measure at issue results in "arbitrary or unjustifiable discrimination" because it conditions the importation of shrimp into the United States on compliance by the exporting Members with policies and standards "unilaterally" prescribed by the United States.⁹⁸ Malaysia asserted that the United States "unilaterally" imposed its domestic standards on exporters.⁹⁹ With respect to this argument, the Panel found:

It seems that whereas the Appellate Body found that requiring the adoption of essentially the same regime constituted arbitrary discrimination, it accepted - at least implicitly - that a requirement that the US and foreign programmes be "comparable in effectiveness" would be compatible with the obligations of the United States under the chapeau of Article XX. This is because it would "permit a degree of discretion or flexibility in how the standards for determining comparability might be applied, in practice, to other countries." We therefore conclude that if, *in practice*, the implementing measure provides for "comparable effectiveness", the finding of the Appellate Body in terms of lack of flexibility will have been addressed.¹⁰⁰ (footnote omitted)

136. Malaysia disagrees with the Panel that a measure can meet the requirements of the chapeau of Article XX if it is flexible enough, both in design and application, to permit certification of an exporting country with a sea turtle protection and conservation programme "comparable" to that of the United States. According to Malaysia, even if the measure at issue allows certification of countries

⁹⁷Panel Report, para. 5.137. We do wish to note, though, that there is one observation by the Panel with which we do not agree. In assessing the good faith efforts made by the United States, the Panel stated that:

The United States is a *demandeur* in this field and given its scientific, diplomatic and financial means, it is reasonable to expect rather more than less from that Member in terms of serious good faith efforts. Indeed, the capacity of persuasion of the United States is illustrated by the successful negotiation of the Inter-American Convention.

(Panel Report, para. 5.76)

We are not persuaded by this line of reasoning. As we stated in our previous Report, the chapeau of Article XX is "but one expression of the principle of good faith". (Appellate Body Report, *United States – Shrimp, supra*, footnote 24, para. 158) This good faith notion applies to all WTO Members equally.

⁹⁸Panel Report, para. 3.131.

⁹⁹*Ibid.*, paras. 3.125 and 3.127.

¹⁰⁰*Ibid.*, para. 5.93.

having regulatory programs "comparable" to that of the United States, and even if the measure is applied in such a manner, it results in "arbitrary or unjustifiable discrimination" because it conditions access to the United States market on compliance with policies and standards "unilaterally" prescribed by the United States. Thus, Malaysia puts considerable emphasis on the "unilateral" nature of the measure, and Malaysia maintains that our previous Report does not support the conclusion of the Panel on this point.¹⁰¹

137. We recall that, in *United States – Shrimp*, we stated:

It appears to us ... 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.¹⁰² (emphasis added)

138. In our view, Malaysia overlooks the significance of this statement. Contrary to what Malaysia suggests, this statement is not "*dicta*". As we said before, it appears to us "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." This statement expresses a principle that was central to our ruling in *United States – Shrimp*.

139. A separate question arises, however, when examining, under the chapeau of Article XX, a measure that provides for access to the market of one WTO Member for a product of other WTO Members *conditionally*. Both Malaysia and the United States agree that this is a common aspect of the measure at issue in the original proceedings and the new measure at issue in this dispute.

¹⁰¹Malaysia's appellant's submission, paras. 3.17-3.19.

¹⁰²Appellate Body Report, *supra*, footnote 24, para. 121.

140. In *United States - Shrimp*, we concluded that the measure at issue there did not meet the requirements of the chapeau of Article XX relating to "arbitrary or unjustifiable discrimination" because, through the application of the measure, the exporting members were faced with "a single, rigid and unbending requirement"¹⁰³ to adopt *essentially the same* policies and enforcement practices as those applied to, and enforced on, domestic shrimp trawlers in the United States. In contrast, in this dispute, the Panel found that this new measure is more flexible than the original measure and has been applied more flexibly than was the original measure. In the light of the evidence brought by the United States, the Panel satisfied itself that this new measure, in design and application, does *not* condition access to the United States market on the adoption by an exporting Member of a regulatory programme aimed at the protection and the conservation of sea turtles that is *essentially the same* as that of the United States.

141. As the Panel's analysis suggests, an approach based on whether a measure requires "essentially the same" regulatory programme of an exporting Member as that adopted by the importing Member applying the measure is a useful tool in identifying measures that result in "arbitrary or unjustifiable discrimination" and, thus, do *not* meet the requirements of the chapeau of Article XX. However, this approach is not sufficient for purposes of judging whether a measure *does* meet the requirements of the chapeau of Article XX. Therefore, in construing our previous Report, the Panel inferred from our reasoning there that a measure requiring United States and foreign regulatory programmes to be "comparable in effectiveness", as opposed to being "essentially the same", would, absent some other shortcoming, comply with the chapeau of Article XX. On this, the Panel stated:

It seems that whereas the Appellate Body found that requiring the adoption of essentially the same regime constituted arbitrary discrimination, it accepted - at least implicitly - that a requirement that the US and foreign programmes be "comparable in effectiveness" would be compatible with the obligations of the United States under the chapeau of Article XX. This is because it would "permit a degree of discretion or flexibility in how the standards for determining comparability might be applied, in practice, to other countries." We therefore conclude that if, *in practice*, the implementing measure provides for "comparable effectiveness", the finding of the Appellate Body in terms of lack of flexibility will have been addressed.¹⁰⁴ (footnote omitted)

142. The Panel reads our previous Report to state that a major deficiency of the original measure was its lack of flexibility, in both design and application. The Panel sees our previous Report as suggesting that the original measure was applied in a manner which constituted "unjustifiable discrimination" essentially "because the application of the measure at issue did not allow for any inquiry into the appropriateness of the regulatory program for the conditions prevailing in the exporting countries."¹⁰⁵ The Panel reasons that a measure that, in its design and application, allows certification of exporting Members having regulatory programmes "comparable in effectiveness" to that of the United States does take into account the specific conditions prevailing in the exporting WTO Members and is, therefore, flexible enough to meet the requirements of the chapeau of Article XX.

143. Given that the original measure in that dispute required "essentially the same" practices and procedures as those required in the United States, we found it necessary in that appeal to rule only that Article XX did not allow such inflexibility. Given the Panel's findings with respect to the flexibility of the new measure in this dispute, we find it necessary in this appeal to add to what we ruled in our original Report. The question raised by Malaysia in this appeal is whether the Panel erred in inferring from our previous Report, and thereby finding, that the chapeau of Article XX permits a measure which requires only "comparable effectiveness".

144. In our view, there is an important difference between conditioning market access on the adoption of essentially the same programme, and conditioning market access on the adoption of a programme *comparable in effectiveness*. Authorizing an importing Member to condition market access on exporting Members putting in place regulatory programmes *comparable in effectiveness* to that of the importing Member gives sufficient latitude to the exporting Member with respect to the programme it may adopt to achieve the level of effectiveness required. It allows the exporting Member to adopt a regulatory programme that is suitable to the specific conditions prevailing in its territory. As we see it, the Panel correctly reasoned and concluded that conditioning market access on the adoption of a programme *comparable in effectiveness*, allows for sufficient flexibility in the application of the measure so as to avoid "arbitrary or unjustifiable discrimination". We, therefore, agree with the conclusion of the Panel on "comparable effectiveness".

¹⁰³Appellate Body Report, *supra*, footnote 24, para. 177.

¹⁰⁴Panel Report, para. 5.93.

¹⁰⁵Panel Report, para. 5.92.

145. Malaysia also argues that the measure at issue is not flexible enough to meet the requirement of the chapeau of Article XX relating to "unjustifiable or arbitrary discrimination" because the Revised Guidelines do not provide explicitly for the specific conditions prevailing in Malaysia.¹⁰⁶

146. We note that the Revised Guidelines contain provisions that permit the United States authorities to take into account the specific conditions of Malaysian shrimp production, and of the Malaysian sea turtle conservation programme, should Malaysia decide to apply for certification. The Revised Guidelines explicitly state that "[i]f the government of a harvesting nation demonstrates that it has implemented and is enforcing a comparably effective regulatory program to protect sea turtles in the course of shrimp trawl fishing without the use of TEDs, that nation will also be eligible for certification."¹⁰⁷ Likewise, the Revised Guidelines provide that the "Department of State will take fully into account any demonstrated differences between the shrimp fishing conditions in the United States and those in other nations as well as information available from other sources."¹⁰⁸

147. Further, the Revised Guidelines provide that the import prohibitions that can be imposed under Section 609 do not apply to shrimp or products of shrimp "harvested in any other manner or under any other circumstances that the Department of State may determine, following consultations with the [United States National Marine Fisheries Services], does not pose a threat of the incidental taking of sea turtles."¹⁰⁹ Under Section II.B(c)(iii) of the Revised Guidelines (*Additional Sea Turtle*

¹⁰⁶ According to Malaysia, the specificity of its case rests on the fact that shrimp trawling is not practised in Malaysia; shrimp is a by-catch from fish trawling and therefore, the incidental catch of sea turtles is due to fish trawling, not shrimp trawling. See, Malaysia's appellant's submission, para. 3.21 and Panel Report, para. 3.128. In addition, Malaysia stated:

Malaysia is a nesting ground but it is not known to be a feeding ground for sea turtles and the nesting season in Malaysia does not overlap with the shrimp season. The Loggerheads and the Kemps released rarely nested on Malaysian beaches and did not occur in Malaysian waters respectively and the high mortality of sea turtles that is reported in the shrimp trawls in the United States relate to both these sea turtles. The Green Turtle, the Hawksbill, Leatherback and Olive Ridley are the major sea turtle species in Malaysia. Green turtles were resident in sea grass beds which were found in shallow coastal waters, whilst the Hawksbills were found in coral reef. Trawling was prohibited in these areas. During the nesting season, the Green turtles remain close to the shore in areas where trawling was also prohibited. During long distance migrations between feeding and nesting grounds, turtles were actively swimming close to the surface of the water which made them more vulnerable to drift nets and long lines rather than trawl nets. In Malaysia, trawling targeted fish for the most part of the year and thus the incidental capture of sea turtles was due to fish trawls and not shrimp trawls.

(Malaysia's response to questioning at the oral hearing)

¹⁰⁷ Revised Guidelines, Section II.B; see, Panel Report, p. 105.

¹⁰⁸ *Ibid.*

¹⁰⁹ Revised Guidelines, Section I.B; see, Panel Report, p. 103.

Protection Measures), the "Department of State recognizes that sea turtles require protection throughout their life-cycle, not only when they are threatened during the course of commercial shrimp trawl harvesting."¹¹⁰ Additionally, Section II.B(c)(iii) states that "[i]n making certification determinations, the Department shall also take fully into account other measures the harvesting nation undertakes to protect sea turtles, including national programmes to protect nesting beaches and other habitat, prohibitions on the direct take of sea turtles, national enforcement and compliance programmes, and participation in any international agreement for the protection and conservation of sea turtles."¹¹¹ With respect to the certification process, the Revised Guidelines specify that a country that does not appear to qualify for certification will receive a notification that "will explain the reasons for this preliminary assessment, suggest steps that the government of the harvesting nation can take in order to receive a certification, and invite the government of the harvesting nation to provide ... any further information." Moreover, the Department of State commits itself to "actively consider any additional information that the government of the harvesting nation believes should be considered by the Department in making its determination concerning certification."¹¹²

148. These provisions of the Revised Guidelines, on their face, permit a degree of flexibility that, in our view, will enable the United States to consider the particular conditions prevailing in Malaysia if, and when, Malaysia applies for certification. As Malaysia has not applied for certification, any consideration of whether Malaysia would be certified would be speculation.¹¹³

¹¹⁰ Revised Guidelines, Section II.B(c)(iii); see, Panel Report, p. 106.

¹¹¹ *Ibid.*

¹¹² Revised Guidelines, Section II.C, Panel Report, p. 107. See also, Revised Guidelines, Section II.D, Panel Report, p. 108.

¹¹³ In this respect, we note that the European Communities stated that:

... the complaint by Malaysia in this case is somewhat premature. As it appears Malaysia has not yet applied for certification and it is therefore not yet clear how the contested legislation would apply to imports of shrimp and shrimp products from Malaysia.

(European Communities' third participant's submission, para. 27)

149. We need only say here that, in our view, a measure should be designed in such a manner that there is sufficient flexibility to take into account the specific conditions prevailing in *any* exporting Member, including, of course, Malaysia.¹¹⁴ Yet this is not the same as saying that there must be specific provisions in the measure aimed at addressing specifically the particular conditions prevailing in *every individual* exporting Member. Article XX of the GATT 1994 does not require a Member to anticipate and provide explicitly for the specific conditions prevailing and evolving in *every individual* Member.

150. We are, therefore, not persuaded by Malaysia's argument that the measure at issue is not flexible enough because the Revised Guidelines do not explicitly address the specific conditions prevailing in Malaysia.

151. Malaysia argues, finally, that the Panel should have scrutinized the decision of the CIT in the *Turtle Island* case and assessed, in the light of that decision, the likelihood and consequences of the Revised Guidelines being modified in the future. According to Malaysia, the Panel should have come to the conclusion that the Revised Guidelines are not flexible enough because the CIT ruled that the part of the Revised Guidelines allowing TED-caught shrimp from non-certified harvesting countries to be imported into the United States is contrary to Section 609.¹¹⁵ As we have already ruled¹¹⁶, we are of the view that, when examining the United States measures, the Panel took into account the status of municipal law at the time, and reached the correct conclusion. The CIT decision in the *Turtle Island* case has not modified the legal effect or the application of the Revised Guidelines; hence, we are not persuaded by this argument of Malaysia.

152. For all these reasons, we uphold the finding of the Panel, in paragraph 6.1 of the Panel Report, that "Section 609 of Public Law 101-162, as implemented by the Revised Guidelines of 8 July 1999 and as applied so far by the [United States] authorities, is justified under Article XX of

the GATT 1994 as long as the conditions stated in the findings of this Report, in particular the ongoing serious, good faith efforts to reach a multilateral agreement, remain satisfied".¹¹⁷

VII. Findings and Conclusions

153. For the reasons set out in this Report, the Appellate Body:

- (a) *finds* that the Panel correctly fulfilled its mandate under Article 21.5 of the DSU of examining the consistency, with the relevant provisions of the GATT 1994, of the United States measure taken to comply with the recommendations and rulings of the DSB in *United States - Shrimp*; and
- (b) *upholds* the finding of the Panel, in paragraph 6.1 of its Report, that "Section 609 of Public Law 101-162, as implemented by the Revised Guidelines of 8 July 1999 and as applied so far by the [United States] authorities, is justified under Article XX of the GATT 1994 as long as the conditions stated in the findings of this Report, in particular the ongoing serious good faith efforts to reach a multilateral agreement, remain satisfied".

154. As we have upheld the Panel's finding that the United States measure is now applied in a manner that meets the requirements of Article XX of the GATT 1994, we do not make any recommendation to the DSB pursuant to Article 19.1 of the DSU.

¹¹⁷Panel Report, para. 6.1. The Panel stated that its findings of justification stand, "*as long as*" certain conditions it set out in its Report, in particular, the good faith efforts to reach a multilateral agreement, continue to be met. In this respect, we note that the United States negotiated and concluded a Memorandum of Understanding with certain countries in the Indian Ocean and South-East Asia region, the South-East Asian MOU. *See, supra*, footnote 96. This agreement took effect on 1 September 2001, almost two and a half months after the circulation of the Panel Report. The participants have not disputed the existence of this agreement. There was some dispute at the oral hearing as to the legally binding nature of this agreement. Basic Principle 4 of that agreement states:

This Memorandum of Understanding, including the Conservation and Management Plan, may be amended by consensus of the signatory States. When appropriate, the signatory States will consider amending this Memorandum of Understanding to make it legally binding.

At the oral hearing, the United States stated that "[The South-East Asian MOU] is considered a political undertaking that does not have binding consequences under international law". Malaysia stated that "[The South-East Asian] MOU ... would have the status of a treaty under the Vienna Convention of the law of treaties, because "treaty" has been defined as an international agreement that is concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments, whatever its particular designation." We need not judge this issue, and we do not. Even so, we note that, whether legally binding or not, the Memorandum of Understanding reinforces the Panel's finding that the United States had indeed made serious good faith efforts to negotiate a multilateral agreement.

¹¹⁴Appellate Body Report, *United States – Shrimp*, *supra*, footnote 24, para. 164.

¹¹⁵Malaysia's appellant's submission, para. 3.25.

¹¹⁶*See, supra*, para. 95.

Signed in the original at Geneva this 2nd day of October 2001 by:

James Bacchus
Presiding Member

A.V. Ganesan
Member

Julio Lacarte-Muró
Member

**WORLD TRADE
ORGANIZATION**

WT/DS135/AB/R
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**

Canada, *Appellant/Appellee*
European Communities, *Appellant/Appellee*

Brazil, *Third Participant*
United States, *Third Participant*

AB-2000-11

Present:

Feliciano, Presiding Member
Bacchus, Member
Ehlermann, Member

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").¹ 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'amiant, pris en application du code de travail et du code de la consommation*) ("the Decree"), which entered into force on 1 January 1997.²

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.

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.³

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

¹WT/DS135/R, 18 September 2000.

²Journal officiel, 26 December 1996.

³WT/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.⁴

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 1994.⁵

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 1994.⁶

⁴Panel Report, paras. 1.1 and 1.2. In its request for the establishment of a panel (WT/DS/135/3, 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.

⁵Panel Report, para. 9.1.

⁶Ibid., 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").⁷ On 16 November 2000, Canada filed an appellant's submission.⁸ On 21 November 2000, the European Communities filed an other appellant's submission.⁹ On 1 December 2000, Canada and the European Communities each filed an appellee's submission.¹⁰ On the same day, Brazil and the United States each filed a third participant's submission.¹¹

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 2001.¹²

9. The oral hearing in the appeal was held on 17 and 18 January 2001.¹³ The participants and the third participants presented oral arguments and responded to questions put to them by Members of the Division hearing the appeal.

⁷WT/DS135/8, 23 October 2000.

⁸Pursuant to Rule 21(1) of the *Working Procedures*.

⁹Pursuant to Rule 23(1) of the *Working Procedures*.

¹⁰Pursuant to Rules 22 and 23(3) of the *Working Procedures*.

¹¹Pursuant to Rule 24 of the *Working Procedures*.

¹²WT/DS135/10, 20 December 2000.

¹³Pursuant to Rule 27 of the *Working Procedures*.

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.

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."¹⁴

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

¹⁴Appellate 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.¹⁵ 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"¹⁶; (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"¹⁷; (iii) the opinion of experts that it has not been established that there is a

¹⁵Panel Report, WT/DS2/R, adopted 20 May 1996, as modified by the Appellate Body Report, WT/DS2/AB/R, DSR 1996:I, 29.

¹⁶Panel Report, para. 8.191.

¹⁷Ibid., para. 8.191 and footnote 147.

threshold below which exposure does not constitute a risk for mesothelioma or lung cancer; (iv) the "Charleston study"¹⁸; (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 Canada¹⁹; (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 levels²⁰; 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.²¹ 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

¹⁸Panel Report, paras. 8.192 and 8.193.

¹⁹Ibid., para. 8.192 and footnote 154.

²⁰Ibid., paras. 8.202 and 8.203.

²¹Ibid., 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"²², 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

²²European Communities' appellee's submission, para. 43.

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.

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".²³

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".²⁴ 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

²³European Communities' other appellant's submission, para. 29.

²⁴Panel 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"²⁵, 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."²⁶ In so finding, the Panel wrongly implied that

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*

1. "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

²⁵Panel Report, para. 8.131.

²⁶*Ibid.*, para. 8.264.

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.²⁷

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

²⁷Appellate 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:I, 323, at 340.

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.

(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.²⁸ 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

²⁸Panel Report, paras. 6.1-6.4 and 8.12-8.14.

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.²⁹ 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:

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.

²⁹WT/DS135/9, 8 November 2000.

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.³⁰ 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

³⁰Such 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 Bridge Associates (United Kingdom); Associação das Indústrias de Produtos de Amianto Crisótilo (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 Métallurgiques (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.³¹ 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.³² 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

³¹Applications 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).

³²Applications 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 appeal³³, 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".

³³These 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.³⁴ 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.³⁵ 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.³⁶

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.³⁷

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 1.1 to the *TBT Agreement*, because, in Canada's view, a general prohibition can be a "technical regulation".

³⁴Panel Report, heading (a) on p. 404 and heading (b) on p. 411.

³⁵*Ibid.*, para. 8.72(a).

³⁶*Ibid.*, para. 8.72.

³⁷*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.³⁸ 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).³⁹

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.

³⁸WT/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.

³⁹The 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.⁴⁰ (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".

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.⁴¹ 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.⁴²

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.⁴³ 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".⁴⁴ 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

⁴⁰Panel 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.

⁴¹Canada 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.

⁴²Article 5 of the Decree characterizes a contravention of any aspect of Articles 1.I or 1.II as a "5th class offence".

⁴³Article 2.II of the Decree.

⁴⁴Article 2.I of the Decree.

scientific and technological progress".⁴⁵ Compliance with these administrative requirements is mandatory.⁴⁶

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".⁴⁷ 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

⁴⁵Article 3.I of the Decree.

⁴⁶Article 3.II of the Decree limits the benefit of the exception to activities that have been the subject of the necessary formalities.

⁴⁷Panel Report, para. 8.69.

to Article 3.3 of the DSU.⁴⁸ 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.⁴⁹

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*".⁵⁰ (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

⁴⁸See, 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).

⁴⁹See 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.

⁵⁰*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 Article 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".⁵¹ 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:4.⁵² 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".⁵³

⁵¹The Panel's approach is set forth in para. 8.111 of the Panel Report.

⁵²Panel Report, para. 8.144.

⁵³*Ibid.*, para. 8.150.

85. In examining the "likeness" of these two sets of products, the Panel adopted an approach based on the Report of the Working Party on *Border Tax Adjustments*.⁵⁴ Under that approach, the Panel employed 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; and, (iv) the tariff classification of the products. The Panel declined to apply "a criterion on the risk of a product", "neither in the criterion relating to the properties, nature and quality of the product, nor in the other likeness criteria ...".⁵⁵

86. On appeal, the European Communities requests that we reverse the Panel's findings that the two sets of products examined by the Panel are "like products" under Article III:4 of the GATT 1994, and requests, in consequence, that we reverse the Panel's finding that the measure is inconsistent with Article III:4 of the GATT 1994. The European Communities contends that the Panel erred in its interpretation and application of the concept of "like products", in particular, in excluding from its analysis consideration of the health risks associated with chrysotile asbestos fibres. According to the European Communities, in this case, Article III:4 calls for an analysis of the health objective of the regulatory distinction made in the measure between asbestos fibres, and between products containing asbestos fibres, and all other products. The European Communities argues that, under Article III:4, products should not be regarded as "like" unless the regulatory distinction drawn between them "entails [a] shift in the competitive opportunities" in favour of domestic products.⁵⁶

B. Meaning of the Term "Like Products" in Article III:4 of the GATT 1994

87. 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)

88. The European Communities' appeal on this point turns on the interpretation of the word "like" in the term "like products" in Article III:4 of the GATT 1994. Thus, this appeal provides us with our

⁵⁴Working Party Report, *Border Tax Adjustments*, adopted 2 December 1970, BISD 18S/97.

⁵⁵Panel Report, paras. 8.130 and 8.132.

⁵⁶European Communities' other appellant's submission, para. 45.

first occasion to examine the meaning of the word "like" in *Article III:4* of the GATT 1994.⁵⁷ Yet, this appeal is, of course, not the first time that the term "like products" has been addressed in GATT or WTO dispute settlement proceedings.⁵⁸ Indeed, the term "like product" appears in many different provisions of the covered agreements, for example, in Articles I:1, II:2, III:2, III:4, VI:1, IX:1, XI:2(c), XIII:1, XVI:4 and XIX:1 of the GATT 1994.⁵⁹ The term is also a key concept in the *Agreement on Subsidies and Countervailing Measures*, the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* (the "Anti-Dumping Agreement"), the

⁵⁷We have already had occasion to interpret other aspects of Article III:4 of the GATT 1994 in two other appeals, but in neither appeal were we asked to address the meaning of the term "like products" (see Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, adopted 25 September 1997, and Appellate Body Report, *Korea – Beef*, *supra*, footnote 49).

⁵⁸See, for instance, Working Party Report, *Brazilian Internal Taxes*, adopted 30 June 1949, BISD II/181, (Article III:2 of the GATT 1947); Working Party Report, *The Australian Subsidy on Ammonium Sulphate ("Australia – Ammonium Sulphate")*, adopted 3 April 1950, BISD II/188 (Articles I and III:4 of the GATT 1947); Panel Report, *Treatment by Germany of Imports of Sardines ("Germany – Sardines")*, adopted 31 October 1952, BISD 15/53 (Articles I and XIII of the GATT 1947); Working Party Report, *Border Tax Adjustments*, *supra*, footnote 54 (Articles II, III and XVI of the GATT 1947); Panel Report, *EEC – Measures on Animal Feed Proteins ("EEC – Animal Feed")*, adopted 14 March 1978, BISD 25S/49 (Articles I, III:2 and III:4 of the GATT 1947); Panel Report, *Spain – Tariff Treatment of Unroasted Coffee*, adopted 11 June 1981, BISD 28S/102 (Article I:1 of the GATT 1947); Panel Report, *Spain – Measures Concerning Domestic Sale of Soyabean Oil ("Spain – Soyabean")*, L/5142, 17 June 1981, unadopted (Article III:4 of the GATT 1947); Panel Report, *Canada – Measures Affecting the Sale of Gold Coins*, L/5863, 17 September 1985, unadopted (Article III:2 of the GATT 1947); Panel Report, *United States – Taxes on Petroleum and Certain Imported Substances*, adopted 17 June 1987, BISD 34S/136 (Article III:2 of the GATT 1947); Panel Report, *Japan – Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages ("1987 Japan – Alcoholic Beverages")*, adopted 10 November 1987, BISD 34S/83 (Article III:2 of the GATT 1947); Panel Report, *Canada/Japan – Tariff on Imports of Spruce, Pine, Fir (SPF) Dimension Lumber*, adopted 19 July 1989, BISD 36S/167 (Article I:1 of the GATT 1947); Panel Report, *United States – Definition of Industry Concerning Wine and Grape Products*, adopted 28 April 1992, BISD 39S/436 (Article VI of the GATT 1947); Panel Report, *United States – Denial of Most-favoured-nation Treatment as to Non-rubber Footwear from Brazil*, adopted 19 June 1992, BISD 39S/128 (Article I:1 of the GATT 1947); Panel Report, *United States – Measures Affecting Alcoholic and Malt Beverages*, adopted 19 June 1992, BISD 39S/206 (Article III:2 and III:4 of the GATT 1947); Panel Report, *United States – Taxes on Automobiles*, DS31/R, 11 October 1994, unadopted (Article III:2 and III:4 of the GATT 1947); Panel Report, *United States – Gasoline*, *supra*, footnote 15 (Article III:4 of the GATT 1994); Panel Report, *Japan – Taxes on Alcoholic Beverages ("Japan – Alcoholic Beverages")*, WT/DS8/R, WT/DS10/R, WT/DS11/R, adopted 1 November 1996, as modified by the Appellate Body Report, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, DSR 1996:I, 125 (Article III:2 of the GATT 1994); Appellate Body Report, *Japan – Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97 (Article III:2 of the GATT 1994); Panel Report, *Canada – Periodicals*, WT/DS31/R, adopted 30 July 1997, as modified by the Appellate Body Report, WT/DS31/AB/R, DSR 1997:I, 481 (Articles III:2 and III:4 of the GATT 1994); Appellate Body Report, *Canada – Periodicals*, *supra*, footnote 48 (Article III:2 of the GATT 1994); Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, adopted 23 July 1998 (Articles I:1 and III:2 of the GATT 1994); Panel Report, *Korea – Taxes on Alcoholic Beverages ("Korea – Alcoholic Beverages")*, 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 (Article III:2 of the GATT 1994); Appellate Body Report, *Korea – Alcoholic Beverages*, WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999 (Article III:2 of the GATT 1994); Panel Report, *Chile – Taxes on Alcoholic Beverages*, WT/DS87/R, WT/DS10/R, adopted 12 January 2000, as modified by the Appellate Body Report, WT/DS87/AB/R, WT/DS10/AB/R (Article III:2 of the GATT 1994).

⁵⁹In addition, the term "like commodity" appears in Article VI:7 and the term "like merchandise" is used in Article VII:2 of the GATT 1994.

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 accordion. The accordion of "likeness" stretches and squeezes in different places as different provisions of the *WTO 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.* ...⁶⁰ (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.⁶¹

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.⁶²

⁶⁰Appellate 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).

⁶¹*The New Shorter Oxford English Dictionary*, Lesley Brown (ed.) Clarendon Press, 1993), Vol. I, p. 1588.

⁶²*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."⁶³ 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".⁶⁴ 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 1994.⁶⁵ 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 4.⁶⁶ 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.

⁶³Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, para. 153.

⁶⁴Appellate Body Report, *Japan – Alcoholic Beverages*, *supra*, footnote 58, at 112 and 113. See, also, Appellate Body Report, *Canada – Periodicals*, *supra*, footnote 48, at 473.

⁶⁵Appellate Body Report, *Japan – Alcoholic Beverages*, *supra*, footnote 58, at 111.

⁶⁶*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.⁶⁷ 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.⁶⁸

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 "accordion" of "likeness" stretches in a different way in Article III:4.

⁶⁷The 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]".

⁶⁸*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.⁶⁹ (emphasis added)

98. As we have said, although this "general principle" is not explicitly invoked in Article III:4, nevertheless, it "informs" that provision.⁷⁰ 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

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, "[n]o one approach ... will be appropriate for all cases."⁷¹ Rather, an assessment utilizing "an unavoidable element of

⁶⁹Appellate Body Report, *Japan – Alcoholic Beverages*, *supra*, footnote 58, at 109 and 110.

⁷⁰*Ibid.*, at 111.

⁷¹Appellate Body Report, *Japan – Alcoholic Beverages*, *supra*, footnote 58, at 114.

individual, discretionary judgement"⁷² 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.⁷³ 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.⁷⁴ 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

⁷²Appellate Body Report, *Japan – Alcoholic Beverages*, *supra*, footnote 58, at 113.

⁷³See, 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.

⁷⁴The 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*

1. 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.⁷⁵

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.⁷⁶ 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."⁷⁷ (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.⁷⁸ The Panel also declined to "[i]ntroduce a criterion on the risk of a product".⁷⁹

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.⁸⁰ The Panel declined to "take a position" on "consumers' tastes and habits", the third criterion, "[b]ecause this criterion would not

⁷⁵European Communities' other appellant's submission, para. 33.

⁷⁶Panel Report, paras. 8.114 and 8.115.

⁷⁷*Ibid.*, para. 8.126.

⁷⁸*Ibid.*, paras. 8.123, 8.124 and 8.126.

⁷⁹*Ibid.*, para. 8.130.

⁸⁰*Ibid.*, para. 8.136.

provide clear results".⁸¹ The Panel observed that consumers' tastes and habits are "very varied".⁸² Finally, the Panel did not regard as "decisive" the different "tariff classification" of the fibres.⁸³

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 1994.⁸⁴

108. The Panel next examined whether *cement-based products containing chrysotile asbestos fibres* are "like" *cement-based products containing PCG fibres*.⁸⁵ 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:4.⁸⁶

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.⁸⁷ 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

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*".⁸⁸ (emphasis added) The Panel expressly acknowledged that, based on physical properties alone, "[i]t could ... be concluded that [the fibres] are *not* like products."⁸⁹ (emphasis added) However, to overcome that fact, the Panel adopted a "market access" approach to this first criterion.⁹⁰ 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.⁹¹ The Panel then stated:

We therefore conclude that, taking into account the properties criterion, chrysotile fibres are like PVA, cellulose and glass fibres.⁹²

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.⁹³ (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

⁸¹Panel Report, para. 8.139.

⁸²*Ibid.*

⁸³*Ibid.*, para. 8.143.

⁸⁴*Ibid.*, para. 8.144.

⁸⁵*Ibid.*

⁸⁶*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.

⁸⁷*Ibid.*, para. 8.126.

⁸⁸Panel Report, para. 8.123.

⁸⁹*Ibid.*, para. 8.121.

⁹⁰*Ibid.*, paras. 8.122 and 8.124.

⁹¹*Ibid.*, paras. 8.123 and 8.125.

⁹²*Ibid.*, para. 8.126.

⁹³*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".⁹⁴ The Panel said that to do so "would largely nullify the effect of Article XX(b)" of the GATT 1994.⁹⁵ 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:

... we note that the carcinogenicity of chrysotile fibres has been acknowledged for some time by international bodies.¹³⁵ 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.

¹³⁵ 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.⁹⁶ 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

⁹⁴Panel Report, para. 8.132.

⁹⁵*Ibid.*, para. 8.130.

⁹⁶Panel 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".⁹⁷ 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."⁹⁸ (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.⁹⁹ 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".¹⁰⁰ 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.¹⁰¹ 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

⁹⁷Panel Report, para. 8.136.

⁹⁸*Ibid.*, para. 8.124.

⁹⁹*Ibid.*, paras. 8.124 and 8.125.

¹⁰⁰*Ibid.*, para. 8.139.

¹⁰¹In 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.¹⁰² 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.¹⁰³ 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.¹⁰⁴ We noted that, in such situations, "it may be highly relevant to examine latent demand" that is suppressed by regulatory barriers.¹⁰⁵ 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

¹⁰²We have already noted the health risks associated with chrysotile asbestos fibres in our consideration of properties (*supra*, para. 114).

¹⁰³We 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.

¹⁰⁴*Supra*, footnote 58, para. 115.

¹⁰⁵*Ibid.*, para. 120. We added that "studies of cross-price elasticity ... involve an assessment of latent demand" (para. 121).

competition."¹⁰⁶ 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.¹⁰⁷ 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

¹⁰⁶*Supra*, footnote 58, para. 137.

¹⁰⁷Panel Report, para. 8.143.

the incorporation of a different fibre.¹⁰⁸ 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."¹⁰⁹ The Panel noted that, for any given cement-based product, the tariff classification is the same, irrespective of the fibre incorporated into the product.¹¹⁰ The Panel declined to examine the "risk" criterion advanced by the European Communities, and also considered it unnecessary to analyze consumers' tastes and habits.¹¹¹ 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."¹¹²

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 1994.¹¹³ 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.¹¹⁴ 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."¹¹⁵ 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

fibre affects the ability of a cement-based product to perform one or more of these functions efficiently.¹¹⁶

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.¹¹⁷

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.

¹⁰⁸Panel Report, para. 8.145.

¹⁰⁹*Ibid.*

¹¹⁰*Ibid.*, para. 8.148.

¹¹¹*Ibid.*, para. 8.149.

¹¹²*Ibid.*, para. 8.150.

¹¹³*Supra*, para. 113.

¹¹⁴*Supra*, para. 114.

¹¹⁵Panel Report, para. 8.203.

¹¹⁶Panel Report, para. 8.145.

¹¹⁷See, further, *supra*, paras. 117 and 118. See, also, *supra*, paras. 121 and 122.

1. 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. ...¹¹⁸

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.¹¹⁹ 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. ...¹²⁰

In contrast, the Panel found that the PCG fibres "are not classified by the WHO at the same level of risk as chrysotile."¹²¹ 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.¹²²

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

¹¹⁸Panel Report, para. 8.121.

¹¹⁹*Supra*, para. 114.

¹²⁰Panel Report, para. 8.188.

¹²¹*Ibid.*, para. 8.220.

¹²²*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.¹²³ 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.¹²⁴ 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.¹²⁵ Canada noted that 90 percent, by quantity, of French imports of chrysotile asbestos were used in the production of cement-based products.¹²⁶ 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.¹²⁷ We have already addressed, and dismissed, the arguments advanced by Canada in support of this contention.¹²⁸ 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

¹²³Panel Report, para. 8.125.

¹²⁴*Ibid.*, para. 3.21.

¹²⁵*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.

¹²⁶Panel Report, para. 3.21, footnote 7.

¹²⁷*Supra*, paras. 120 and 123.

¹²⁸*Ibid.*

"like" under Article III:4 of the GATT 1994.¹²⁹ 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.¹³⁰

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".¹³¹

143. The Panel stated that the fibres give the cement-based products their specific function – "mechanical strength, resistance to heat, compression, etc."¹³² 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.

¹²⁹Our reasons for reaching this conclusion are set forth, *supra*, in paras. 117, 118, 121 and 122.

¹³⁰Canada 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).

¹³¹Panel Report, para. 8.203.

¹³²*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.¹³³ 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.¹³⁴ 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.¹³⁵ 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.¹³⁶ 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.¹³⁷ 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

¹³³*Supra*, para. 129.

¹³⁴*Supra*, paras. 120 and 123.

¹³⁵*Supra*, para. 117.

¹³⁶*Supra*, para. 130.

¹³⁷Panel 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]anels 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"¹³⁸, which property is not shared by the PCG fibres, "at least to the same extent."¹³⁹ 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."¹⁴⁰ (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*

¹³⁸*Supra*, para. 114.

¹³⁹*Ibid.*

¹⁴⁰*Ibid.*

carcinogenic risk associated with the inhalation of chrysotile fibres."¹⁴¹ (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

¹⁴¹Panel 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."¹⁴² (emphasis added) On the basis of this assessment of the evidence, the Panel concluded that:

¹⁴²Panel 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.* ...¹⁴³ (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.¹⁴⁴ 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.¹⁴⁵

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.¹⁴⁶

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:

¹⁴³Panel Report, para. 8.194.

¹⁴⁴Canada's appellant's submission, para. 170. The seven factors Canada relies upon are identified in para. 19 of this Report.

¹⁴⁵Canada's appellant's submission, para. 171.

¹⁴⁶Supra, 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 ...¹⁴⁷ (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."¹⁴⁸ (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.¹⁴⁹ 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.

¹⁴⁷Supra, footnote 58, para. 161.

¹⁴⁸Appellate Body Report, *United States – Wheat Gluten*, supra, footnote 48, para. 151.

¹⁴⁹Panel 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.¹⁵⁰

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."¹⁵¹ 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.¹⁵² 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.¹⁵³ 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."¹⁵⁴ 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.¹⁵⁵ 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.

¹⁵⁰Panel Report, para. 8.222.

¹⁵¹Canada's appellant's submission, para. 187.

¹⁵²Ibid., paras. 188 and 189.

¹⁵³Ibid., para. 193.

¹⁵⁴Ibid., para. 195.

¹⁵⁵Supra, 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.¹⁵⁶ 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."¹⁵⁷ 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.¹⁵⁸ 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 accepted¹⁵⁹, 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 fibres¹⁶⁰, 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."¹⁶¹ We understand Canada to mean by this that an alternative measure is only excluded as a "reasonably available" alternative if implementation 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.¹⁶² 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*.¹⁶³ (emphasis added)

171. In our Report in *Korea – Beef*, we addressed the issue of "necessity" under Article XX(d) of the GATT 1994.¹⁶⁴ 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.¹⁶⁵

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

¹⁵⁶Appellate Body Report, *European Communities – Hormones*, *supra*, footnote 48, para. 186.

¹⁵⁷Panel Report, para. 8.202.

¹⁵⁸*Ibid.*, para. 8.188. See Panel Report, para. 5.29, for a description of mesothelioma given by Dr. Henderson.

¹⁵⁹*Ibid.*, para. 8.204.

¹⁶⁰*Ibid.*, para. 8.220.

¹⁶¹Canada's appellant's submission, para. 202, referring to, *inter alia*, para. 130 of that submission.

¹⁶²See Panel Report, *United States – Gasoline*, *supra*, footnote 15, paras. 6.26 and 6.28.

¹⁶³Adopted 20 February 1990, BISD 37S/200, para. 75.

¹⁶⁴*Supra*, footnote 49, paras. 159 ff.

¹⁶⁵Adopted 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.

pursued".¹⁶⁶ 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.¹⁶⁷ 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.¹⁶⁸ 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."¹⁶⁹ 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.¹⁷⁰ 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.

¹⁶⁶ Appellate Body Report, *Korea – Beef*, *supra*, footnote 49, paras. 166 and 163.

¹⁶⁷ *Ibid.*, para. 162.

¹⁶⁸ Panel Report, para. 8.209.

¹⁶⁹ *Ibid.*, paras. 8.209 and 8.211.

¹⁷⁰ *Ibid.*, paras. 8.213 and 8.214.

C. Article II 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."¹⁷¹ 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.¹⁷² 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."¹⁷³

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.¹⁷⁴ 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]."¹⁷⁵ 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."¹⁷⁶ (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,

¹⁷¹ Canada's appellant's submission, para. 204.

¹⁷² *Ibid.*

¹⁷³ *Ibid.*, para. 209.

¹⁷⁴ *Ibid.*, para. 204.

¹⁷⁵ Appellate Body Report, *Korea – Alcoholic Beverages*, *supra*, footnote 58, para. 161. See, *supra*, para. 160.

¹⁷⁶ *Supra*, footnote 48, para. 194.

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."¹⁷⁷ 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.¹⁷⁸ 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".¹⁷⁹ We also note that the experts were instructed by the Panel to answer only those questions that fell within their area of expertise.¹⁸⁰ As Canada indicates, several experts indicated that particular questions, or parts of questions, posed to them went beyond their area of expertise.¹⁸¹

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.

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 1994.¹⁸² 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).¹⁸³

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.¹⁸⁴ 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".¹⁸⁵ 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

¹⁷⁷Panel Report, para. 5.1.

¹⁷⁸*Ibid.*, para. 5.20.

¹⁷⁹*Ibid.*

¹⁸⁰*Ibid.*, para. 5.22.

¹⁸¹Canada's appellant's submission, para. 211, footnote 219, referring to Panel Report, paras. 5.335, 5.345, 5.346, 5.353, 5.363, 5.364, 5.370, 5.371, and 5.374, and to Annex VI of the Panel Report, para. 222.

¹⁸²Panel Report, para. 8.255.

¹⁸³*Ibid.*, para. 8.257.

¹⁸⁴*Ibid.*, paras. 8.265 and 8.274.

¹⁸⁵*Ibid.*, para. 8.304.

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.¹⁸⁶ (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'.¹⁸⁷ That panel stated:

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.*¹⁸⁸ (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

¹⁸⁸Supra, 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, 7February 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, 20February 1985, unadopted; Panel Report, *Japan – Trade in Semi-Conductors*, adopted 4 May 1988, BISD 3SS/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 7November 1990, BISD 37S/228; Panel Report, *Japan – Film*, *supra*, footnote 187; Panel Report, *Korea – Measures Affecting Government Procurement*, WT/DS163/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).

¹⁸⁶Adopted 25 January 1990, BISD 37S/86, para. 144.

¹⁸⁷Adopted 22 April 1998, WT/DS44/R, para. 10.37.

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 1994.¹⁸⁹ 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

¹⁸⁹See 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:

Florentino P. Feliciano
Presiding Member

James Bacchus
Member

Claus-Dieter Ehlermann
Member

**WORLD TRADE
ORGANIZATION**

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UNITED STATES – SUBSIDIES ON UPLAND COTTON

AB-2004-5

Report of the Appellate Body

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<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:I, 515
<i>Argentina – Textiles and Apparel</i>	Panel Report, <i>Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items</i> , WT/DS56/R, adopted 22 April 1998, as modified by the Appellate Body Report, WT/DS56/AB/R, DSR 1998:III, 1033
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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

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<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
<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:I, 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>EEC – Animal Feed Proteins</i>	GATT Panel Report, <i>EEC – Measures on Animal Feed Proteins</i> , adopted 14 March 1978, BISD 25S/49
<i>EEC – Apples I (Chile)</i>	GATT Panel Report, <i>EEC Restrictions on Imports of Apples from Chile</i> , adopted 10 November 1980, BISD 27S/98
<i>India – Autos</i>	Panel Report, <i>India – Measures Affecting the Automotive Sector</i> , WT/DS146/R, WT/DS175/R and Corr.1, adopted 5 April 2002
<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:I, 9
<i>Indonesia – Autos</i>	Panel Report, <i>Indonesia – Certain Measures Affecting the Automobile Industry</i> , WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R and Corr.1, 2, 3, and 4, adopted 23 July 1998, DSR 1998:VI, 2201
<i>Italy – Agricultural Machinery</i>	GATT Panel Report, <i>Italian Discrimination Against Imported Agricultural Machinery</i> , adopted 23 October 1958, BISD 7S/60
<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:I, 97
<i>Japan – Apples</i>	Appellate Body Report, <i>Japan – Measures Affecting the Importation of Apples</i> , WT/DS245/AB/R, adopted 10 December 2003
<i>Korea – Alcoholic Beverages</i>	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:I, 44
<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:I, 3
<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>US – Canadian Tuna</i>	GATT Panel Report, <i>United States – Prohibition of Imports of Tuna and Tuna Products from Canada</i> , adopted 22 February 1982, BISD 29S/91
<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

<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:I, 373
<i>US – Certain EC Products</i>	Panel Report, <i>United States – Import Measures on Certain Products from the European Communities</i> , WT/DS165/R and Add.1, adopted 10 January 2001, as modified by the Appellate Body Report, WT/DS165/AB/R, DSR 2001:II, 413
<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 – Cotton Yarn</i>	Appellate Body Report, <i>United States – Transitional Safeguard Measure on Combed Cotton Yarn from Pakistan</i> , WT/DS192/AB/R, adopted 5 November 2001, DSR 2001:XI, 6027
<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" – Recourse to Article 21.5 of the DSU by the European Communities</i> , WT/DS108/AB/RW, adopted 29 January 2002, DSR 2002:I, 55
<i>US – FSC (Article 21.5 – EC)</i>	Panel 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/RW, adopted 29 January 2002, as modified by the Appellate Body Report, WT/DS108/AB/RW, DSR 2002:I, 119
<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:I, 3
<i>US – Hot-Rolled Steel</i>	Appellate Body Report, <i>United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan</i> , WT/DS184/AB/R, adopted 23 August 2001, DSR 2001:X, 4697
<i>US – Lamb</i>	Appellate Body Report, <i>United States – Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia</i> , WT/DS177/AB/R, WT/DS178/AB/R, adopted 16 May 2001, DSR 2001:IX, 4051
<i>US – Lead and Bismuth II</i>	Appellate Body Report, <i>United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom</i> , WT/DS138/AB/R, adopted 7 June 2000, DSR 2000:V, 2595
<i>US – Line Pipe</i>	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
<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, DSR 2002:II, 589
<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 – Softwood Lumber IV</i>	Appellate Body Report, <i>United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada</i> , WT/DS257/AB/R, adopted 17 February 2004
<i>US – Steel Safeguards</i>	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

<i>US – Wheat Gluten</i>	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
<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:I, 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:I, 343

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
MLA 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 ("US – Upland Cotton")</i> , 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>

WORLD TRADE ORGANIZATION
APPELLATE BODY

United States – Subsidies on Upland Cotton

United States, *Appellant/Appellee*
Brazil, *Appellant/Appellee*

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*

AB-2004-5

Present:

Janow, Presiding Member
Baptista, Member
Ganesan, Member

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").¹ The Panel was established on 18 March 2003 to consider claims by Brazil regarding various United States measures² 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

¹WT/DS267/R, 8 September 2004.

²Brazil 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.³

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 payments⁴, DP payments⁵, 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*;

³The 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

⁴Production 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.

⁵Direct 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^[6] 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^[7], GSM 103^[8] and SCGP^[9] 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*,

⁶In 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 program 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)

⁷General 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.

⁸General 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.

⁹Supplier 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^[10] 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*;

¹⁰Farm Security and Rural Investment Act of 2002 (the "FSRI Act of 2002"); Public Law 107-171.

- (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^[11] and CCP payments^[12] -- 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

^[11]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.

^[12]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.

- the effect of the United States subsidy measures listed in paragraph 7.1107 of Section VII:G of this report^[13] 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*^[14]; 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).^[15] 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'."^[16]

^[13]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".

^[14]Panel Report, para. 8.3(a).

^[15]*Ibid.*, paras. 8.3(b) and 8.3(c).

^[16]*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 Appeal¹⁷ pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "Working Procedures").¹⁸ On 28 October 2004, the United States filed its appellant's submission.¹⁹ On 2 November 2004, Brazil filed an other appellant's submission.²⁰ On 16 November 2004, Brazil and the United States each filed an appellee's submission.²¹

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.²² 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.²³

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

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.²⁴

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".²⁵ 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.

¹⁷WT/DS267/17, 18 October 2004, attached as Annex 1 to this Report.

¹⁸WT/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.

¹⁹Pursuant 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*.

²⁰Pursuant to Rule 23(1) of the *Working Procedures*.

²¹Pursuant to Rules 22 and 23(3) of the *Working Procedures*, respectively.

²²Pursuant to Rule 24(1) of the *Working Procedures*.

²³Pursuant 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.

²⁴On 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)

²⁵United 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 requests²⁶, 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 program²⁷ are not exempt from actions by virtue of paragraph (a) of Article 13 of the

²⁶Request 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.

²⁷Panel 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")²⁸, 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).²⁹ 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."³⁰ 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

²⁸Paragraph 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.

²⁹Panel Report, paras. 7.376-7.382.

³⁰United 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, his 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".³¹ 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

³¹United 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".³² 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 be *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)(ii). The ordinary meaning of this phrase encompasses "assistance" or "backing" "specially ... pertaining to a particular" 'agricultural crop' or ... for a 'precise,

³²United States' appellant's submission, para. 45 (quoting paragraph 11(a) of Annex 2 to the *Agreement on Agriculture*).

exact, definite' 'agricultural crop".³³ 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

³³United 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".³⁴ 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".³⁵ 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)(ii) 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.

³⁴United States' appellant's submission, para. 96 (quoting Panel Report, para. 7.502).

³⁵Ibid.

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".³⁶ 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*".³⁷ 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'".³⁸

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.

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.

³⁶United States' appellant's submission, para. 65 (quoting *The New Shorter Oxford English Dictionary*, L. Brown (ed.) (Clarendon Press, 1993), Vol. 1, p. 1131).

³⁷*Ibid.*, para. 65 (quoting *The New Shorter Oxford English Dictionary*, L. Brown (ed.) (Clarendon Press, 1993), Vol. 1, p. 607). (original emphasis)

³⁸*Ibid.*, para. 66 (quoting Panel Report, para. 7.487).

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 subsidies³⁹ 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".⁴⁰ 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

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'".⁴¹ 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".⁴² However, according to the United States, the "relevant economic decision"⁴³ 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,

³⁹The 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))

⁴⁰United States' appellant's submission, para. 311.

⁴¹United States' appellant's submission, para. 158.

⁴²*Ibid.*, para. 162 (quoting Panel Report, para. 7.1308).

⁴³*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"⁴⁴ 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"⁴⁵ 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,

users, and/or exporters of upland cotton".⁴⁶ 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*⁴⁷ provides an "economically neutral" allocation methodology⁴⁸, 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 benefiting 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"⁴⁹ 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 IV* 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*.⁵⁰ 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

⁴⁴United States' appellant's submission, para. 208 (referring to Panel Report, paras. 7.1351-7.1352).
⁴⁵*Ibid.*, para. 258.

⁴⁶"Calculation of the Total Ad Valorem Subsidization (Paragraph 1(a) of Article 6)".

⁴⁷United States' appellant's submission, para. 269.

⁴⁸*Ibid.*, para. 303.

⁴⁹*Ibid.*, paras. 304 and 305 (referring to Appellate Body Report, *US – Softwood Lumber IV*, 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"⁵¹ 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.⁵²

45. According to the United States, an annually recurring subsidy should be "allocated" or "expensed"⁵³ 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".⁵⁴

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*.

⁵¹United States' appellant's submission, para. 296.

⁵²*Ibid.*, para. 327.

⁵³*Ibid.*, para. 283.

⁵⁴*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*.⁵⁵ 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.⁵⁶ 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 guarantees⁵⁷ to facilitate the export of United States agricultural commodities other than upland cotton were within its

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.⁵⁸ 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".⁵⁹ 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.

⁵⁵United States' appellant's submission, paras. 444-445 (referring to Panel Report, *Canada – Dairy*, para. 7.41 and footnote 496 to para. 7.124).

⁵⁶Ibid., paras. 447-452 (referring to Panel Report, paras. 7.718 and 7.725).

⁵⁷The 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.

⁵⁸United States' appellant's submission, para. 466 (referring to Appellate Body Report, *Brazil – Aircraft*, para. 131).

⁵⁹Ibid., 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 panels terms of reference because it was not the subject of consultations.⁶⁰ Similarly, in this case, export credit guarantees to other agricultural commodities may not form part of the Panels 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.⁶¹ 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

⁶⁰United States' appellant's submission, para. 485 (referring to Appellate Body Report, *US – Certain EC Products*, para. 70).

⁶¹Ibid., 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".⁶² 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"⁶³ 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*")⁶⁴, 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 of Agriculture*, the export subsidy disciplines of the

⁶²Quoting from Article 10.2 of the *Agreement on Agriculture*.

⁶³United States' appellant's submission, para. 379 (quoting Panel Report, para. 7.940).

⁶⁴Done 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)".⁶⁵ 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"⁶⁶ 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".⁶⁷ According to the United States, "[t]o 'avoid a net cost' prospectively is simply not the requirement of item (j)", and the "likelihood"

⁶⁵United States' appellant's submission, para. 406 (quoting Panel Report, para. 7.859). (emphasis added by the United States)

⁶⁶*Ibid.*, para. 407 (quoting Panel Report, para. 7.857).

⁶⁷*Ibid.*, para. 407 (quoting Panel Report, para. 7.805).

standard of performance" imposed by the Panel is higher than that found in item (j).⁶⁸ 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."⁶⁹ 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".⁷⁰

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.⁷¹

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

⁶⁸United States' appellant's submission, para. 407.

⁶⁹Ibid., 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)

⁷⁰United States' appellant's submission, para. 419.

⁷¹Ibid., 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".⁷² 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

⁷²Brazil'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 1996⁷³ 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.⁷⁴ 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

⁷³Federal Agriculture Improvement and Reform Act of 1996 (the "FAIR Act of 1996"); Public Law 104-127.

⁷⁴Brazil'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."⁷⁵ 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"⁷⁶, 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.

⁷⁵Brazil's appellee's submission, para. 291 (quoting the United States' appellant's submission, para. 22).

⁷⁶*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)(ii) 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".⁷⁷ 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)(ii) 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."⁷⁸ 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.⁷⁹ 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)(ii) readily available terms, such as "product-specific" and "non-product-specific"

(and the definitions in Articles 1(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".⁸⁰ 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

⁷⁷Brazil's appellee's submission, para. 358 (quoting Panel Report, para. 7.494).

⁷⁸*Ibid.*, para. 371 (quoting Panel Report, para. 7.483).

⁷⁹*Ibid.*, para. 383 (quoting Panel Report, para. 7.636).

⁸⁰Brazil's appellee's submission, para. 390 (quoting Panel Report, para. 7.491).

proviso.⁸¹ 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."⁸² 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."⁸³ The Panel concluded by stating that "[d]ecided" refers to what the government determines, but 'grant' refers to what its measures provide.⁸⁴ 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'".⁸⁵ 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*".⁸⁶

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

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."⁸⁷ 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' arguments⁸⁸, 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

⁸¹Brazil's appellee's submission, para. 340 (quoting Panel Report, para. 7.435).

⁸²Panel Report, para. 7.435.

⁸³*Ibid.*, para. 7.436.

⁸⁴*Ibid.*, para. 7.476.

⁸⁵Brazil's appellee's submission, para. 346 (quoting the United States' appellant's submission, para. 66).

⁸⁶*Ibid.*, para. 346 (quoting Panel Report, para. 7.557). (emphasis added by Brazil)

⁸⁷Panel Report, para. 7.555.

⁸⁸Brazil 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".⁸⁹ 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").⁹⁰ Brazil maintains that the Panel found, as a matter of fact, that a world market exists for upland cotton.⁹¹ 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.⁹² 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.⁹³ In Brazil's view, the Panel found that "Brazilian prices, *i.e.*, prices in Brazil and prices received for Brazilian exports, are significantly suppressed".⁹⁴

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.⁹⁵ 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

signals.⁹⁶ 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"⁹⁷ 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".⁹⁸ 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

⁸⁹Brazil's appellee's submission, para. 628. (original emphasis)

⁹⁰*Ibid.*, para. 633. (emphasis omitted)

⁹¹*Ibid.*, paras. 619 and 622 (referring to Panel Report, paras. 7.1274 and 7.1311).

⁹²*Ibid.*, paras. 644 and 808 (referring to Panel Report, paras. 7.1266, 7.1282-7.1284 and 7.1313).

⁹³*Ibid.*, paras. 799-801 (referring to Panel Report, paras 7.1311 and 7.1313).

⁹⁴*Ibid.*, para. 802.

⁹⁵*Ibid.*, paras. 793-798 (referring to Panel Report, paras. 7.1205, 7.1209, and 7.1215).

⁹⁶Brazil's appellee's submission, para. 168 (referring to the United States' appellant's submission, para. 324).

⁹⁷*Ibid.*, para. 788 (referring to the United States' appellant's submission, para. 224).

⁹⁸*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.⁹⁹

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"¹⁰⁰ 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

⁹⁹Brazil's appellee's submission, para. 523 (quoting Panel Report, para. 7.1226).

¹⁰⁰*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"¹⁰¹ 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.¹⁰² 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.¹⁰³ 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

¹⁰¹Brazil's appellee's submission, para. 570.

¹⁰²*Ibid.*, para. 832 (referring to Appellate Body Report, *US – Cotton Yarn*, para. 120).

¹⁰³*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.¹⁰⁴ 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.¹⁰⁵ 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.¹⁰⁶ 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

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.¹⁰⁷ 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

¹⁰⁴Brazil's appellee's submission, para. 860 (referring to GATT Panel Report, *Italy – Agricultural Machinery*, para. 16).

¹⁰⁵*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).

¹⁰⁶*Ibid.*, para. 890 (referring to the United States' appellant's submission, para. 444).

¹⁰⁷Brazil'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.¹⁰⁸ 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.¹⁰⁹ 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*.¹¹⁰ 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.¹¹¹ The evidence

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(e) 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.¹¹² 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

¹⁰⁸Brazil's appellee's submission, para. 211 (quoting Panel Report, para. 7.61).

¹⁰⁹*Ibid.*, para. 213 (referring to Appellate Body Report, *Brazil – Aircraft*, paras. 132-133).

¹¹⁰*Ibid.*, paras. 228-229 (referring to Appellate Body Report, *US – FSC*, para. 161).

¹¹¹*Ibid.*, para. 226 (referring to Panel Report, paras. 7.92-7.93).

¹¹²Brazil'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.¹¹³ 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.¹¹⁴ 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".¹¹⁵ 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 10.1.¹¹⁶ 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.

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*.¹¹⁷

(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*.¹¹⁸ 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*.¹¹⁹

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.¹²⁰ 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.

¹¹³Brazil's appellee's submission, para. 940 (quoting the United States' appellant's submission, para. 350).

¹¹⁴*Ibid.*, para. 940 (quoting paragraph 3, FAO "Principles of Surplus Disposal and Consultative Obligations", and Article IX(d) of the Food Aid Convention).

¹¹⁵*Ibid.*, para. 926 (quoting the United States' appellant's submission, para. 384).

¹¹⁶*Ibid.*, para. 927.

¹¹⁷At 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.

¹¹⁸Brazil's appellee's submission, paras. 1023-1024 (referring to Panel Report, para. 7.867).

¹¹⁹*Ibid.*, para. 1024 (referring to Panel Report, paras. 7.946-7.948).

¹²⁰*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.¹²¹ 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

¹²¹Brazil'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".¹²² "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".¹²³ 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*.

¹²²Brazil's other appellant's submission, para. 246. (emphasis added by Brazil)

¹²³Ibid., 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"¹²⁴ and to find instead that "world market share" means "world market share of exports".¹²⁵ 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

¹²⁴Brazil's other appellant's submission, para. 269 (quoting Panel Report, para. 7.1434).

¹²⁵*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)".¹²⁶

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"¹²⁷ 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.¹²⁸ 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

¹²⁶Brazil's other appellant's submission, para. 287.

¹²⁷*Ibid.*, para. 295.

¹²⁸*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".¹²⁹ 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"¹³⁰ 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".¹³¹ 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.

¹²⁹Brazil'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).

¹³⁰*Ibid.*, para. 314 (quoting Appellate Body Report, *Canada – Periodicals*, p. 24, DSR 1997:1, 449 at 469).

¹³¹*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".¹³²

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*.¹³³ 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*.

¹³²Brazil'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*).

¹³³*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.¹³⁴ Brazil also takes issue with the Panel's statement that a "threat" could not arise if circumvention was just a *possibility*.¹³⁵

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.¹³⁶ 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

¹³⁴Brazil's other appellant's submission, paras. 85-89 (quoting Panel Report, paras. 7.883 and 7.892).

¹³⁵*Ibid.*, paras. 89 and 114 (referring to Panel Report, para. 7.893).

¹³⁶*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" circumvention¹³⁷, 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.¹³⁸

152. Brazil also contends that the Panel erred by confining its examination of threat of circumvention to scheduled agricultural products other than rice and to unscheduled products "not supported"¹³⁹ under the United States' export credit guarantee programs.¹⁴⁰ 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.

¹³⁷Brazil's other appellant's submission, paras. 126-129 (quoting Appellate Body Report, *US - FSC*, para. 152).

¹³⁸*Ibid.*, para. 105.

¹³⁹When 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)

¹⁴⁰Brazil'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 2001.¹⁴¹ 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

¹⁴¹In 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 guarantees¹⁴² 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 economy¹⁴³ 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.

¹⁴²Brazil's other appellant's submission, paras. 29-30 (referring to Appellate Body Report, *Canada – Aircraft*, paras. 154, 157).

¹⁴³*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"¹⁴⁴ 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.¹⁴⁵ 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)*.¹⁴⁶

¹⁴⁴Brazil's other appellant's submission, para. 214.

¹⁴⁵*Ibid.*, para. 222.

¹⁴⁶*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.¹⁴⁷ 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.

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."¹⁴⁸ 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.

¹⁴⁷Brazil'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.

¹⁴⁸United 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".¹⁴⁹ 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*)

¹⁴⁹United 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 uncontroversial 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"¹⁵⁰ 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

¹⁵⁰United States' appellee's submission, para. 164.

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"¹⁵¹ 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.¹⁵² 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".¹⁵³ 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.

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

¹⁵¹United States' appellee's submission, para. 182.

¹⁵²*Ibid.*, para. 183 (quoting Brazil's other appellant's submission, para. 373).

¹⁵³*Ibid.*, para. 6 (quoting Brazil's other appellant's submission, para. 3).

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.¹⁵⁴ 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".¹⁵⁵

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.

(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

¹⁵⁴The United States also rejected the allegations in respect of vegetable oil made by Brazil in its other appellant's submission.

¹⁵⁵United States' appellee's submission, para. 50 (referring to Appellate Body Report, *US – Steel Safeguards*, para. 498).

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 "forfaiting"¹⁵⁶; 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.

(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.

¹⁵⁶United States' appellee's submission, para. 93.

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 2000.¹⁵⁷ 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*".¹⁵⁸ 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 shift" that Brazil gave to the ETI Act of 2000 satisfied Brazil's burden to make its *prima facie* case concerning that Act.¹⁵⁹

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 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*

¹⁵⁷United 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:I, 323 at 340).

¹⁵⁸*Ibid.*, para. 106 (quoting Brazil's written submission to the Panel, paras. 315-327).

¹⁵⁹*Ibid.*, para. 12.

case should be interpreted similarly to a panels 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".¹⁶⁰ 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.

(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.¹⁶¹

(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.¹⁶²

(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.

¹⁶⁰Argentina's third participant's submission, para. 15 (quoting Panel Report, para. 7.386).

¹⁶²*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 "[f]ound[ed], buil[t] or construct[ed]" on the type of production or the volume of production undertaken by a producer in a later period.¹⁶³ 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.¹⁶⁴ 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.¹⁶⁵

(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*.

¹⁶³ 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*).

¹⁶⁴ *Ibid.*, para. 19 (referring to the United States' appellant's submission, paras. 150 and 322-331).

¹⁶⁵ *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".¹⁶⁶ 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".¹⁶⁷

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"¹⁶⁸, 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

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.¹⁶⁹

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".¹⁷⁰ 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*".¹⁷¹ 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

¹⁶⁶Benin and Chad's third participants' submission, para. 85. (emphasis omitted)

¹⁶⁷*Ibid.*, para. 6 (quoting Panel Report, para. 7.1403).

¹⁶⁸*Ibid.*, para. 9.

¹⁶⁹Canada's third participant's submission, para. 13 (quoting Panel Report, para. 7.366).

¹⁷¹*Ibid.*, para. 20 (quoting the United States' appellant's 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*.¹⁷²

(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".¹⁷³ 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".¹⁷⁴

¹⁷² Canada's third participant's submission, para. 40 (referring to Appellate Body Report, *US – FSC*, para. 152).

¹⁷³ China's third participant's submission, para. 19.

¹⁷⁴ *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)".¹⁷⁵ 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

¹⁷⁵ 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"¹⁷⁶ 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".¹⁷⁷

(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

¹⁷⁷European Communities' third participant's submission, para. 6 (quoting Appellate Body Report, *EC – Bananas III*, para. 155).

¹⁷⁶European Communities' third participant's submission, para. 61.

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"¹⁷⁸ 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

¹⁷⁸New 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 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, 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*¹⁷⁹; 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

¹⁷⁹Brazil'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*.

support" in the implementation period and that "decided during 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*¹⁸⁰;

(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(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, 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*;

(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 2001¹⁸¹;
- (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

¹⁸⁰Brazil'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*.

¹⁸¹At 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 1994.¹⁸²

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.¹⁸³

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

¹⁸²Brazil'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*.

¹⁸³Notwithstanding 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 2002¹⁸⁴, 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.¹⁸⁵

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.¹⁸⁶ 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.¹⁸⁷

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.¹⁸⁸ 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.¹⁸⁹

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."¹⁹⁰ 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

¹⁸⁴See 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. I-84, para. 35.

¹⁸⁵For 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.

¹⁸⁶See Panel Report, paras. 7.104 and 7.113.

¹⁸⁷See Panel Report, para. 7.105.

¹⁸⁸*Ibid.*, para. 7.108.

¹⁸⁹*Ibid.*, para. 7.118.

¹⁹⁰*Ibid.*, para. 7.121.

does not address the issue of the status of the measures at all.¹⁹¹ 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.¹⁹²

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 panel¹⁹³), 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.¹⁹⁴

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.¹⁹⁵ 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.¹⁹⁶ 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.¹⁹⁷

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".¹⁹⁸ The United States focuses on the present tense of the verb "affecting" in this Article and contends that expired measures cannot be measures "affecting", in the present, the operation of a covered agreement.¹⁹⁹ Thus, according to the

¹⁹¹Panel Report, para. 7.121.

¹⁹²*Ibid.*, para. 7.122.

¹⁹³*Ibid.*, para. 7.127. This finding has not been appealed.

¹⁹⁴*Ibid.*, para. 7.128. This final finding was reiterated in paragraph 7.194(ii) of the Panel Report.

¹⁹⁵United States' Notice of Appeal, *supra*, footnote 17, para. 14; United States' appellant's submission, para. 515.

¹⁹⁶United States' appellant's submission, para. 150.

¹⁹⁷*Ibid.*, para. 500.

¹⁹⁸United States' appellant's submission, para. 501 (quoting Article 4.2 of the DSU). (emphasis added by the United States)

¹⁹⁹*Ibid.*, para. 501.

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.²⁰⁰

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.²⁰¹

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

²⁰⁰United States' appellant's submission, paras. 502 and 512.

²⁰¹Brazil'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".²⁰²

261. We agree with the Panel that the word "affecting" refers primarily to "the way in which [measures] relate to a covered agreement".²⁰³ 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.²⁰⁴ 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.²⁰⁵

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.²⁰⁶ 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.²⁰⁷ 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

²⁰²United States' appellant's submission, para. 501. (emphasis added)

²⁰³Panel Report, para. 7.115.

²⁰⁴Appellate Body Report, *EC – Bananas III*, para. 220.

²⁰⁵This does not exclude the possibility that the effects of a measure may occur in future.

²⁰⁶United States appellant's submission, para. 501.

²⁰⁷Appellate 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 DSU²⁰⁸, 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.²⁰⁹ 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.²¹⁰

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.²¹¹

²⁰⁸Article 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.

²⁰⁹Indeed, 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)

²¹⁰Whether 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.

²¹¹Panel 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.²¹²

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.²¹³ 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.²¹⁴

²¹²This 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)

²¹³Appellate Body Report, *US – Certain EC Products*, paras. 81-82.

²¹⁴This 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.²¹⁵ 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)*:

²¹⁵We 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.²¹⁶

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.²¹⁷

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."²¹⁸

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

²¹⁶Appellate 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 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)

²¹⁷*Ibid.*, para. 108.

²¹⁸*Ibid.*, para. 109.

on to discuss relevant factual aspects.²¹⁹ The Panel cited and discussed Article 4.2, in particular the meaning and significance of the term "affecting" in that provision.²²⁰ As we have done, the Panel interpreted Article 4.2 in the light of the context provided by Article 3.3 of the DSU.²²¹ It addressed Article 6.2 of the DSU²²², and also situated the question of "expired measures" in the context of the actionable subsidies claims made by Brazil in this case.²²³ 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.²²⁴

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".²²⁵ 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".²²⁶

²¹⁹Panel Report, para. 7.108.

²²⁰*Ibid.*, paras. 7.112-7.115.

²²¹*Ibid.*, para. 7.116-7.117.

²²²*Ibid.*, para. 7.121.

²²³*Ibid.*, paras. 7.109-7.110.

²²⁴We 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))

²²⁵Panel Report, para. 7.55. (footnote omitted)

²²⁶*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".²²⁷ 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".²²⁸ 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".²²⁹ 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.²³⁰

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.²³¹ 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.²³² 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.²³³

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

²²⁷Panel Report, para. 7.61. (original italics; underlining added)

²²⁸*Ibid.*, para. 7.62.

²²⁹*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)

²³⁰Panel Report, para. 7.69. (footnote omitted)

²³¹United States' appellant's submission, para. 474.

²³²*Ibid.*, para. 471.

²³³*Ibid.*, paras. 471-472.

Credit Guarantee Program (the "SCGP").²³⁴ By their own terms, each of these measures applies to all eligible products.²³⁵ Therefore, there was no need to specify the product scope of these measures.²³⁶ 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.²³⁷ 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.²³⁸

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.²³⁹

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

²³⁴These programs are described *infra*, paras. 586-589.

²³⁵See Panel Report, footnote 1056 to para. 7.875.

²³⁶Brazil's appellee's submission, para. 195.

²³⁷*Ibid.*, para. 202.

²³⁸Brazil'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)

²³⁹In 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.

panel's terms of reference are governed by the request for establishment of a panel".²⁴⁰ However, the Appellate Body has also explained that "as a general matter, consultations are a prerequisite to panel proceedings"²⁴¹ 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.²⁴²

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".²⁴³ 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

²⁴⁰Appellate 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.

²⁴¹Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 58.

²⁴²*Ibid.*, para. 54.

²⁴³Appellate Body Report, *Brazil – Aircraft*, para. 131.

measures identified in the request for the establishment of a panel".²⁴⁴ 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.²⁴⁵ According to the Panel, "[t]his shows that the *actual* consultations did include export credit guarantee measures relating to all eligible agricultural commodities".²⁴⁶ 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".²⁴⁷

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".²⁴⁸ 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

²⁴⁴Appellate 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)

²⁴⁵The 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)

²⁴⁶Panel Report, para. 7.61. (original emphasis)

²⁴⁷*Ibid.*, para. 7.62.

²⁴⁸Panel 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".²⁴⁹ 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 part²⁵⁰:

The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton¹, 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.

¹ Except with respect to export credit guarantee programs as explained below.

²⁴⁹Panel Report, para. 7.65.

²⁵⁰Request for Consultations by Brazil, *supra*, footnote 26, pp. 1-2 and 4.

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 guarantee measures only, was different from those 'provided to US producers, users and/or exporters of upland cotton'".²⁵¹ 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."²⁵²

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".²⁵³ The United States also asserts that the Panel "overlooked the context that th[e] first paragraph provided for the second".²⁵⁴ 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".²⁵⁵ 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".²⁵⁶ 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".²⁵⁷

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'".²⁵⁸ 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".²⁵⁹

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".²⁶⁰ 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 cotton²⁶¹ and, consequently, this argument does not support the United States' position on this issue.

²⁵¹Panel Report, para. 7.63.

²⁵²*Ibid.*, para. 7.65.

²⁵³United States' appellant's submission, para. 476 (quoting Panel Report, para. 7.64). (original emphasis)

²⁵⁴*Ibid.*, para. 477.

²⁵⁵*Ibid.*, (original emphasis)

²⁵⁶*Ibid.*, para. 477.

²⁵⁷*Ibid.*, para. 479.

²⁵⁸Panel Report, para. 7.63.

²⁵⁹*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)

²⁶⁰United States' appellant's submission, para. 461.

²⁶¹See *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".²⁶² 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"²⁶³ 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.²⁶⁴

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

1. 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 4.2 ... of that Agreement".²⁶⁵

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 programs²⁶⁶, and observed that the first paragraph is "textually limited to upland cotton", while the second paragraph "is not so limited".²⁶⁷ 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.²⁶⁸ 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".²⁶⁹ 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

²⁶⁵Panel 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*.

²⁶⁶Panel Report, para. 7.83.

²⁶⁷*Ibid.*, para. 7.84.

²⁶⁸*Ibid.*, para. 7.84.

²⁶⁹*Ibid.*, para. 7.85. (footnote 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.

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".²⁷⁰

298. Therefore, the Panel found:

[A]ssuming *arguendo* that the United States' request was timely²⁷¹, 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*.²⁷²

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.²⁷³ 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.²⁷⁴ 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.²⁷⁵

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*.²⁷⁶ 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, which are central elements in a determination of whether a program constitutes an export subsidy

²⁷⁰Panel Report, paras. 7.92-7.93.

²⁷¹Brazil 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)

²⁷²Panel Report, para. 7.103. (footnotes omitted)

²⁷³United States' appellant's submission, para. 494.

²⁷⁴*Ibid.*, paras. 495-496.

²⁷⁵United States' appellant's submission, para. 497.

²⁷⁶Brazil's appellee's submission, paras. 228-229 (referring to Appellate Body Report, *US – FSC*, para. 161).

under item (j) of the Illustrative List of Export Subsidies included as Annex I to the *SCM Agreement*.²⁷⁷ 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.²⁷⁸ 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.²⁷⁹

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.²⁸⁰ 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".²⁸¹ It has also explained that the

²⁷⁷Brazil's appellee's submission, para. 230.

²⁷⁸*Ibid.*, paras. 231-232 (referring to Panel Report, paras. 7.92-7.93).

²⁷⁹*Ibid.*, para. 233.

²⁸⁰The 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.

²⁸¹Appellate 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".²⁸²

303. Brazil's statement of available evidence is annexed to its request for consultations. As the Panel noted²⁸³, 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[.]²⁸⁴

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".²⁸⁵ 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

each of the three challenged United States export subsidy programmes as they relate to upland cotton and other eligible agricultural products".²⁸⁶

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"²⁸⁷ 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."²⁸⁸

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".²⁸⁹

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".²⁹⁰ 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

²⁸²Appellate Body Report, *US – FSC*, para. 161.

²⁸³Panel Report, para. 7.83.

²⁸⁴Statement of available evidence annexed to the Request for Consultations by Brazil, *supra*, footnote 26, para. 3.

²⁸⁵Panel Report, para. 7.85. (footnote omitted) The text of footnote 1 is reproduced, *supra*, footnote 269.

²⁸⁶Panel Report, para. 7.86.

²⁸⁷United States' appellant's submission, para. 497.

²⁸⁸Panel Report, para. 7.89 (quoting statement of available evidence, *supra*, footnote 284, para. 3).

²⁸⁹*Ibid.*, para. 7.90.

²⁹⁰Appellate 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".²⁹¹

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'".²⁹² 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.²⁹³

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)

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.²⁹⁴

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.²⁹⁵ 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.²⁹⁶ Like production flexibility contract payments for upland cotton, direct payments for upland cotton were dependent on base acres allocated by reference to the

²⁹¹Statement of available evidence annexed to the Request for Consultations by Brazil, *supra*, footnote 26, para. 3.

²⁹²Panel Report, para. 7.100.

²⁹³Panel Report, *Australia – Automotive Leather II*, para. 9.19.

²⁹⁴Panel 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)

²⁹⁵*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.

²⁹⁶*Ibid.*, para. 7.220.

production of upland cotton during certain base periods.²⁹⁷ 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.²⁹⁸

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."²⁹⁹ 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*.³⁰⁰ The Panel concluded that these measures are thus not green box measures³⁰¹, 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."³⁰²

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.³⁰³ Nor does the United States dispute that there are limitations on producers' ability to plant any product, if those producers wish to receive production flexibility or direct payments with respect to upland cotton base acres.³⁰⁴ In the

²⁹⁷There 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.

²⁹⁸Panel 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.

²⁹⁹*Ibid.*, para. 7.385.

³⁰⁰*Ibid.*, para. 7.388.

³⁰¹*Ibid.*, para. 7.413.

³⁰²*Ibid.*, para. 7.414.

³⁰³United States' appellant's submission, para. 17.

³⁰⁴See, for example, United States' appellant's submission, paras. 17 ff.

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.³⁰⁵ 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.³⁰⁶

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*.³⁰⁷ 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.³⁰⁸ 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.³⁰⁹

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 categories is identical: in both cases, production is channelled *away from* certain "prohibited" crops

³⁰⁵United States' appellant's submission, para. 18.

³⁰⁶*Ibid.*

³⁰⁷Panel Report, para. 7.385; United States' appellant's submission, paras. 22 ff.

³⁰⁸Panel Report, para. 7.385; Brazil's appellee's submission, paras. 260 ff.

³⁰⁹Brazil'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.

(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.³¹⁰

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 period³¹¹, 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 Support: The Basis for Exemption from the Reduction Commitments" and provides, in relevant part, as follows:

³¹⁰Brazil's appellee's submission, paras. 285-286 (quoting Panel Report, para. 7.386).

³¹¹The "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 is "the calendar, financial or marketing year specified in the Schedule relating to that Member".

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.
- ...
- (e) *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 above³¹², 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.³¹³ 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).

³¹²*Supra*, para. 314.

³¹³United 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 things³¹⁴, 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).³¹⁵ 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".³¹⁶ 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".³¹⁷ 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

³¹⁴See *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.

³¹⁵The Panel noted that "base" in this context may be defined as to "found, build, or construct (*up*)on 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", the expression "based on" also requires a connection between two or more things. However, even though "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".

³¹⁶Panel Report, para. 7.366.

³¹⁷United 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".³¹⁸ 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.³¹⁹ 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".³²⁰ However, in our view, the mere fact that under paragraph 6(e) "[n]o production shall be required in

³¹⁸Panel Report, para. 7.368.

³¹⁹United States' appellant's submission, paras. 38-42.

³²⁰*Ibid.*, para. 38. (emphasis omitted)

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.³²¹ 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".³²² 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.³²³ 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".³²⁴ However, for the United States, in that case, the only "amount" of payment that is even arguably "related to" current production is "zero"³²⁵, 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

³²¹Panel 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)

³²²Panel Report, para. 7.386.

³²³*Ibid.*, para. 7.386.

³²⁴United States' appellant's submission, para. 26.

³²⁵*Ibid.*

to production "attempted" by the recipient; rather, the amount of payment is related to or based on the type of production *not* "attempted".³²⁶

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'",³²⁷ because their only effects are to reduce production of the prohibited crops.³²⁸ 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.³²⁹ 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.³³⁰

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"

the policy-specific criteria and conditions set out in the remaining paragraphs of Annex 2, including those in paragraph 6.³³¹

334. As we have noted, the Panel found that the planting flexibility limitations in this case "significantly constrain" production decisions.³³² 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 (e) below". Criterion 11(e) 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(e) 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(e), 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.

³²⁶United States' appellant's submission, para. 27.

³²⁷Paragraph 1 of Annex 2 to the *Agreement on Agriculture*.

³²⁸United States' appellant's submission, para. 36.

³²⁹See *ibid.*, paras. 32-35.

³³⁰Brazil's responses to questioning at the oral hearing.

³³¹We 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)

³³²*Ibid.*, para. 7.386.

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 financial or physical restructuring of a producer's operations"³³³ 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".³³⁴ 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.³³⁵

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.³³⁶ 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

³³³Paragraph 11(a) of Annex 2 to the *Agreement on Agriculture*.

³³⁴United States' appellant's submission, paras. 45-47.

³³⁵*Ibid.*, para. 47.

³³⁶*Ibid.*, paras. 53-55 and footnote 45.

holders of upland cotton base acres. Our interpretation of paragraph 6(b) would not prevent a WTO 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.³³⁷ 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 countries³³⁸ or payments under certain environmental programs.³³⁹

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.³⁴⁰ Brazil conditionally appeals the

³³⁷Brazil's appellee's submission, para. 315.

³³⁸Article 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".

³³⁹See paragraph 12 of Annex 2 to the *Agreement on Agriculture*.

³⁴⁰Panel Report, para. 7.393.

Panel's exercise of judicial economy on the issue of whether the base period update under the direct payments program is consistent with paragraph 6(a) of Annex 2.³⁴¹ 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.³⁴² 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; ...

³⁴¹Brazil's other appellant's submission, paras. 237 ff.

³⁴²The "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.³⁴³

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).³⁴⁴

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 "grant[ed] 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.³⁴⁵ 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.³⁴⁶

³⁴³Step 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)

³⁴⁴The 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)

³⁴⁵*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)

³⁴⁶*Ibid.*, para. 7.598.

350. After finding that evidence and arguments presented by the United States did not rebut Brazil's case³⁴⁷, 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*.³⁴⁸

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"³⁴⁹, which would exclude payments under these "non-product-specific" base acre dependent measures.³⁵⁰ 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"³⁵¹, 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.³⁵²

³⁴⁷Panel Report, para. 7.607.

³⁴⁸*Ibid.*, para. 7.608.

³⁴⁹United States' appellant's submission, para. 93.

³⁵⁰*Ibid.*, para. 105.

³⁵¹Panel Report, para. 7.494(i).

³⁵²United 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.³⁵³ 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".³⁵⁴ 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.³⁵⁵

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.³⁵⁶ 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.³⁵⁷

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.³⁵⁸ 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

³⁵³Marketing 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)

³⁵⁴*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.

³⁵⁵*Ibid.*, paras. 69-75.

³⁵⁶*Ibid.*, paras. 120-122.

³⁵⁷*Ibid.*, paras. 122-124.

³⁵⁸Brazil's appellee's submission, para. 330.

box measures, that clearly or explicitly define a commodity as one to which they bestow or confer support".³⁵⁹

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.³⁶⁰ 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 provides³⁶¹, 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.³⁶² 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.³⁶³ 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.³⁶⁴

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*

³⁵⁹Brazil's appellee's submission, paras. 369 and 385 (quoting Panel Report, para. 7.481).

³⁶⁰*Ibid.*, para. 350.

³⁶¹*Ibid.*, paras. 344 ff.

³⁶²*Ibid.*, paras. 346 and 351.

³⁶³*Ibid.*, paras. 352 ff.

³⁶⁴*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.³⁶⁵ 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*.³⁶⁶ 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 payments³⁶⁷, market loss assistance payments³⁶⁸, direct payments³⁶⁹ and counter-cyclical payments³⁷⁰. 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.³⁷¹

³⁶⁵The United States characterizes these measures as "decoupled" from production. (United States' appellant's submission, para. 104)

³⁶⁶On 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)

³⁶⁷We describe briefly production flexibility contract payments *supra*, para. 311.

³⁶⁸Market 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)

³⁶⁹We describe briefly direct payments *supra*, para. 312.

³⁷⁰Counter-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)

³⁷¹We 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"³⁷²; similarly, the Panel found³⁷³ and the participants agree³⁷⁴ 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"³⁷⁵ and as "specially or peculiarly pertaining to a particular thing or person, or a class of these; peculiar (*to*)".³⁷⁶ 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

³⁷²See 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.

³⁷³Panel Report, paras. 7.480 and 7.518-7.520.

³⁷⁴See United States' appellant's submission, paras. 85 and 104; and Brazil's appellee's submission, para. 385.

³⁷⁵Panel Report, para. 7.481 (quoting *The New Shorter Oxford English Dictionary*, L. Brown (ed.) (Clarendon Press, 1993), Vol. 2, p. 2972).

³⁷⁶*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".³⁷⁷ 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.³⁷⁸ 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.³⁷⁹

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"³⁸⁰ and "support ... provided for an agricultural product in favour of the producers of the basic agricultural product".³⁸¹ 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

³⁷⁷Panel Report, para. 7.494(i).

³⁷⁸*Ibid.*, paras. 7.510-7.517.

³⁷⁹Although 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.

³⁸⁰This phrase is found in Article 1(h) of the *Agreement on Agriculture*. (United States' appellant's submission, para. 88)

³⁸¹This 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.³⁸²

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."³⁸³ 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.³⁸⁴ 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.

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.³⁸⁵

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

³⁸²We 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.

³⁸³Panel Report, para. 7.470.

³⁸⁴The 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).

³⁸⁵United 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.³⁸⁶ 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.³⁸⁷ 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.³⁸⁸ 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.³⁸⁹ For the United States, there is "[no] question that payments cannot be deemed to grant support to a crop the recipient does not produce".³⁹⁰ In addition, the United States contends that the Panel erred in finding that the base acre dependent programs "clearly and explicitly specif[y] upland cotton ... as a commodity to which they grant support".³⁹¹ 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.³⁹² 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'.³⁹³

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

³⁸⁶We 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. 7.217)

³⁸⁷See Panel Report, para. 7.596 and "Attachment to Section VII:D" (Panel Report, paras. 7.634-7.647).

³⁸⁸*Ibid.*, paras. 7.580-7.583.

³⁸⁹United States' appellant's submission, para. 106.

³⁹⁰*Ibid.*

³⁹¹*Ibid.*, para. 103 (quoting Panel Report, para. 7.518).

³⁹²United States' appellant's submission, para. 104.

³⁹³*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)

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".³⁹⁴ 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"³⁹⁵, and that "the overwhelming majority of farms enrolled in the programmes which plant upland cotton also hold upland cotton base".³⁹⁶

377. We note in this regard that the Panel included, in "Attachment to Section VII:D" to its Report, and described as "appropriate"³⁹⁷, 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.³⁹⁸ 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 present "support to [the] specific commodity" upland cotton. We agree that none of the base acre

³⁹⁴Panel Report, para. 7.637.

³⁹⁵*Ibid.*, para. 7.636. (footnote omitted)

³⁹⁶*Ibid.*, para. 7.636.

³⁹⁷*Ibid.*, para. 7.646.

³⁹⁸See *Ibid.*, paras. 7.640-7.642.

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.³⁹⁹

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.⁴⁰⁰ The Panel also observed that, in the case of each of the measures, a particular payment rate was specified for upland cotton.⁴⁰¹ Yield calculations were also specific to upland cotton and related to historical upland cotton yields per acre.⁴⁰² In the case of market loss assistance payments, payments were specifically designed to compensate for low prices for upland cotton.⁴⁰³ 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.⁴⁰⁴ 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 cotton* base acres.⁴⁰⁵ Indeed, we see little in the Panel's finding or on the record that would allow us

³⁹⁹Panel Report, para. 7.484.

⁴⁰⁰*Ibid.*, paras. 7.513-7.516.

⁴⁰¹*Ibid.*, para. 7.635.

⁴⁰²See *ibid.*, paras. 7.513-7.516.

⁴⁰³*Ibid.*, para. 7.515.

⁴⁰⁴*Ibid.*, para. 7.516.

⁴⁰⁵See *supra*, footnote 184.

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"⁴⁰⁶ 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.⁴⁰⁷ In advancing this contention, the United States relies upon the following statement of the Panel:

[If] 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.⁴⁰⁸

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".⁴⁰⁹ 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.⁴¹⁰ 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 Article 13(b)(ii). What is relevant for the comparison is the support that the measure actually grants

⁴⁰⁶Panel Report, para. 7.646.

⁴⁰⁷United States appellant's submission, paras. 64-67 and 114-117.

⁴⁰⁸Panel Report, para. 7.487.

⁴⁰⁹United States appellant's submission, para. 66.

⁴¹⁰Panel Report, para. 7.476.

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.⁴¹¹ 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*.⁴¹²

(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.⁴¹³

386. Payments to upland cotton under the marketing loan program could take one of several forms. In each case, 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

⁴¹¹Thus, 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.

⁴¹²For 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.

⁴¹³United 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*.

"loan rate" fixed, from time to time, for the marketing loan program.⁴¹⁴ 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.⁴¹⁵

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*.⁴¹⁶

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.⁴¹⁷ 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.⁴¹⁸ The Panel chose to rely upon actual budgetary outlays⁴¹⁹, but

⁴¹⁴For a description of payments under the marketing loan program, see Panel Report, paras. 7.204 7.208.

⁴¹⁵For a description of deficiency payments, see Panel Report, footnote 294 to para. 7.213.

⁴¹⁶United States' appellant's submission, paras. 71-73 (quoting paragraph 10 of Annex 3 to the *Agreement on Agriculture*).

⁴¹⁷Panel Report, para. 7.552.

⁴¹⁸Paragraph 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.

⁴¹⁹See, 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.⁴²⁰

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.⁴²¹

(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".⁴²²

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

⁴²⁰See 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.

⁴²¹At 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)

⁴²²We 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.⁴²³

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 outlays⁴²⁴ or price gap methodology⁴²⁵, 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)

⁴²³For 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.

⁴²⁴See Table 1 of Annex 2.

⁴²⁵See Table 2 of Annex 2.

of the *SCM Agreement*. In doing so, we examine the United States' objections to the "market" and "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.⁴²⁶ 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.⁴²⁷

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

⁴²⁶Brazil's appellee's submission, paras. 105 and 146.

⁴²⁷*Ibid.*, para. 146.

the Appellate Body will not interfere lightly with the Panel's discretion "as the trier of facts".⁴²⁸ 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".⁴²⁹ 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.⁴³⁰ 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 suggested⁴³¹, and the parties agree⁴³², 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.⁴³³ 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".⁴³⁴

⁴²⁸"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.

⁴²⁹Appellate Body Report, *EC – Hormones*, para. 132.

⁴³⁰On 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.

⁴³¹Panel Report, para. 7.1246.

⁴³²The United States and Brazil indicated their agreement on this point in response to questioning during the oral hearing.

⁴³³Panel Report, para. 7.1230.

⁴³⁴*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".⁴³⁵ Applying this interpretation to the facts of the present dispute, the Panel concluded that a "world market" for upland cotton does exist.⁴³⁶ 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".⁴³⁷ In the present dispute, having found that "price suppression has occurred in the same world market"⁴³⁸, the Panel decided that it was not "necessary to proceed to any further examination of ... alleged price suppression in individual country markets".⁴³⁹ 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".⁴⁴⁰ It also submits that the Panel's finding that a "world market" exists for upland cotton is inconsistent with certain of its other findings.⁴⁴¹ 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.⁴⁴² Brazil contends that significant price suppression under Article 6.3(c) "may apply to any 'market' from local to global, and everything in between".⁴⁴³

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:

...

⁴³⁵Panel Report, paras. 7.1238-7.1240.

⁴³⁶*Ibid.*, para. 7.1247.

⁴³⁷*Ibid.*, para. 7.1252.

⁴³⁸*Ibid.*, para. 7.1312.

⁴³⁹*Ibid.*, para. 7.1315.

⁴⁴⁰United States' appellant's submission, para. 307.

⁴⁴¹*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).

⁴⁴²United States' appellant's submission, para. 321.

⁴⁴³Brazil'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:⁴⁴⁴

"a place ... with a demand for a commodity or service"¹³⁵⁵; "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".¹³⁵⁶

¹³⁵⁵ *The New Shorter Oxford English Dictionary*, (1993).

¹³⁵⁶ *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.⁴⁴⁵ 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".⁴⁴⁶

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 Panel⁴⁴⁷ 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

⁴⁴⁴Panel Report, para. 7.1236.

⁴⁴⁵As indicated by the United States and Brazil in response to questioning during the oral hearing.

⁴⁴⁶Panel Report, para. 7.1237.

⁴⁴⁷*Ibid.*, paras. 7.1238-7.1240.

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.⁴⁴⁸

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.⁴⁴⁹ The phrase "in the same market" suggests that the subsidized product in question (United States upland cotton in this case)⁴⁵⁰ 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 cotton⁴⁵¹ and Brazilian upland cotton⁴⁵² must be "in the same market" for Brazil's claim under Article 6.3(c) to succeed.⁴⁵³ Furthermore, the participants agree that these are like products.⁴⁵⁴

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"⁴⁵⁵, 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

⁴⁴⁸This 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.

⁴⁴⁹Panel Report, paras. 7.1248 and 7.1251; United States' appellant's submission, para. 310; Brazil's appellee's submission, paras. 636 and 638.

⁴⁵⁰See *infra*, footnote 451.

⁴⁵¹Specifically, 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)

⁴⁵²Panel 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.

⁴⁵³Accordingly, 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".

⁴⁵⁴Panel Report, paras. 7.1248 and 7.1251; United States' appellant's submission, para. 310; Brazil's appellee's submission, paras. 636 and 638.

⁴⁵⁵Panel Report, para. 7.1236 (quoting *Merriam-Webster Dictionary online*).

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.⁴⁵⁶ This market for a particular product could well be a "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.⁴⁵⁷ 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.⁴⁵⁸ 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*.⁴⁵⁹

411. We now examine the United States' objection to the Panel's examination of the "world market for upland cotton"⁴⁶⁰ 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"

⁴⁵⁶Panel Report, para. 7.1237 and footnote 1357 to para. 7.1240.

⁴⁵⁷*Ibid.*, footnote 1357 to para. 7.1240.

⁴⁵⁸"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)

⁴⁵⁹Panel Report, paras. 7.1238-7.1244.

⁴⁶⁰*Ibid.*, paras. 7.1247 and 7.1274.

represented by the A-Index.⁴⁶¹ 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 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 exists⁴⁶² and that a world price in that market also exists and is reflected in the A-Index.⁴⁶³ We see no reason to disturb the Panel's findings of fact in this regard.⁴⁶⁴

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.⁴⁶⁵ As we explained earlier⁴⁶⁶, 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"⁴⁶⁷ and "where competition exists between Brazilian and United States upland cotton".⁴⁶⁸

413. Whether or not Brazilian and United States upland cotton competed in the "world market for upland cotton"⁴⁶⁹ during the period the Panel examined is a factual question. As we stated earlier⁴⁷⁰, 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

⁴⁶¹United States' appellant's submission, para. 319 (referring to Panel Report, para. 7.1213).

⁴⁶²Panel Report, paras. 7.1245-7.1252.

⁴⁶³*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)

⁴⁶⁴See Appellate Body Report, *EC – Hormones*, para. 132. See also Appellate Body Report, *US – Wheat Gluten*, para. 151.

⁴⁶⁵United States' appellant's submission, para. 320.

⁴⁶⁶*Supra*, paras. 407-408.

⁴⁶⁷Panel Report, para. 7.1248.

⁴⁶⁸*Ibid.*, para. 7.1251.

⁴⁶⁹*Ibid.*, paras. 7.1247 and 7.1274.

⁴⁷⁰*Supra*, para. 408.

Brazilian like upland cotton is found".⁴⁷¹ 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 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".⁴⁷²

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".⁴⁷³ 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'."⁴⁷⁴

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"⁴⁷⁵, and that the Panel was correct in examining the world market for upland cotton in the present dispute.⁴⁷⁶ 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.

⁴⁷¹Panel Report, para. 7.1230.

⁴⁷²*Ibid.*, para. 7.1313. See also *ibid.*, para. 7.1246.

⁴⁷³Panel 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)

⁴⁷⁴United States' appellant's submission, para. 239.

⁴⁷⁵*Supra*, para. 410.

⁴⁷⁶*Supra*, para. 414.

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:

[P]rices for upland cotton transactions throughout the world are ... largely determined by the A-Index price.⁴⁷⁷

Therefore, the Panel found that the A-Index adequately reflected prices in the world market for upland cotton.⁴⁷⁸ 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".⁴⁷⁹ 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'".⁴⁸⁰

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)⁴⁸¹ 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".⁴⁸² Next, the Panel found that the price suppression it had found to exist was "significant" price suppression under Article 6.3(c)⁴⁸³, "given the relative magnitude of United States production and exports, the overall

⁴⁷⁷Panel Report, para. 7.1311.

⁴⁷⁸*Ibid.*, para. 7.1274.

⁴⁷⁹*Ibid.*, para. 7.1313.

⁴⁸⁰United States' appellant's submission, para. 238.

⁴⁸¹Panel Report, para. 7.1312.

⁴⁸²*Ibid.*, para. 7.1280.

⁴⁸³*Ibid.*, para. 7.1333.

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".⁴⁸⁴

420. The Panel went on to find that "a causal link exists between" the price-contingent subsidies and the significant price suppression it had found⁴⁸⁵, for four main reasons:⁴⁸⁶

[T]he United States exerts a substantial proportionate influence in the world upland cotton market.⁴⁸⁷

[T]he [price-contingent subsidies] are directly linked to world prices for upland cotton, thereby insulating United States producers from low prices.⁴⁸⁸

[T]here is a discern[i]ble temporal coincidence of suppressed world market prices and the price-contingent United States subsidies.⁴⁸⁹

[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.⁴⁹⁰

421. Finally, the Panel found that the following "other causal factors alleged by the United States"⁴⁹¹ "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'"⁴⁹².

⁴⁸⁴Panel Report, para. 7.1332. (footnotes omitted) We address the United States' arguments regarding the magnitude or quantification of the subsidies *infra*, paras. 459-472.

⁴⁸⁵Panel Report, para. 7.1355.

⁴⁸⁶*Ibid.*, para. 7.1347.

⁴⁸⁷*Ibid.*, para. 7.1348.

⁴⁸⁸*Ibid.*, para. 7.1349.

⁴⁸⁹*Ibid.*, para. 7.1351.

⁴⁹⁰*Ibid.*, para. 7.1353. (footnotes omitted)

⁴⁹¹*Ibid.*, para. 7.1357.

⁴⁹²*Ibid.*, para. 7.1363.

[W]eakness in world demand for cotton due to competing, low-priced synthetic fibres, and weak world economic growth.⁴⁹³

[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[.]⁴⁹⁴

[T]he strong United States dollar since the mid-1990's[.]⁴⁹⁵

China subsidized the release of millions of bales of government stocks between 1999 and 2001[.]⁴⁹⁶

[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.⁴⁹⁷

(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*.⁴⁹⁸ 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"⁴⁹⁹;
- (ii) ignoring data indicating that United States upland cotton production responded to market signals⁵⁰⁰;

(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"⁵⁰¹; and

(iv) "the four main, cumulative grounds the Panel identified supporting a finding of causation do not withstand scrutiny"⁵⁰²;

(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"⁵⁰³;

(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"⁵⁰⁴; and

(iii) failing to determine "the extent to which processed cotton benefits from subsidies provided with respect to raw cotton"⁵⁰⁵; 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"⁵⁰⁶; 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".⁵⁰⁷

⁴⁹³Panel Report, para. 7.1358.

⁴⁹⁴*Ibid.*, para. 7.1359.

⁴⁹⁵*Ibid.*, para. 7.1360.

⁴⁹⁶*Ibid.*, para. 7.1361.

⁴⁹⁷*Ibid.*, para. 7.1362.

⁴⁹⁸*Ibid.*, paras. 7.1416 and 8.1(g)(i).

⁴⁹⁹United States' appellant's submission, paras. 136 and 154.

⁵⁰⁰*Ibid.*, para. 155.

⁵⁰¹United States' appellant's submission, para. 227.

⁵⁰²*Ibid.*, para. 180.

⁵⁰³*Ibid.*, para. 240.

⁵⁰⁴*Ibid.*, para. 264.

⁵⁰⁵*Ibid.*, para. 301.

⁵⁰⁶*Ibid.*, para. 277.

⁵⁰⁷*Ibid.*, para. 278.

(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".⁵⁰⁸ 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:

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.¹³⁸⁸

¹³⁸⁸ 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"⁵⁰⁹ 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)⁵¹⁰, as required by Article 33(3) of the *Vienna Convention on the Law of Treaties* (the "*Vienna Convention*").⁵¹¹

⁵⁰⁸ According to the Panel, Brazil claimed that certain United States subsidies "significantly suppress[ed] upland cotton prices" within the meaning of Article 6.3(c). (Panel Report, para. 7.1108(i))

⁵⁰⁹ Panel Report, para. 7.1277.

⁵¹⁰ 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)

⁵¹¹ 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."

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.⁵¹²

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".⁵¹³

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).⁵¹⁴ 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"?⁵¹⁵

Is it "significant" price suppression?⁵¹⁶

"The effect of the subsidy"⁵¹⁷

⁵¹² Panel Report, para. 7.1288. See also *ibid.*, para. 7.1279.

⁵¹³ *Ibid.*, para. 7.1326.

⁵¹⁴ *Ibid.*, para. 7.1228.

⁵¹⁵ *Ibid.*, heading (ii) to paras. 7.1275-7.1315.

⁵¹⁶ *Ibid.*, heading (iii) to paras. 7.1316-7.1333.

⁵¹⁷ *Ibid.*, heading (k) to paras. 7.1334-7.1363.

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?"⁵¹⁸ 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).⁵¹⁹

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*.⁵²⁰ 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

⁵¹⁸United States' appellant's submission, para. 230. (original emphasis)

⁵¹⁹*Ibid.*, para. 131.

⁵²⁰Annex V contains "Procedures for Developing Information Concerning Serious Prejudice".

suppression without taking into account the effect of the subsidies.⁵²¹ The Panel's definition of price suppression, explained above⁵²², 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".⁵²³ 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.⁵²⁴

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".⁵²⁵ 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"⁵²⁶ is clearly relevant to significant price suppression (although, as the Panel itself recognized, price trends alone are not conclusive).⁵²⁷ 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"⁵²⁸ amounts to legal error for that reason alone.

⁵²¹Similarly, it might be difficult to ascertain whether imports or exports are "displace[d]" or "impede[d]" 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.

⁵²²*Supra*, para. 423.

⁵²³Panel Report, para. 7.1277. (emphasis added)

⁵²⁴An 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.

⁵²⁵Panel Report, para. 7.1280.

⁵²⁶*Ibid.*, para. 7.1286. See also *ibid.*, para. 7.1310.

⁵²⁷*Ibid.*, para. 7.1288.

⁵²⁸We discuss these factors *infra*, paras. 449 and 450.

435. Turning to the Panel's assessment of the "effect of the subsidy"⁵²⁹, the Panel addressed the question whether there was a "causal link"⁵³⁰ between the price-contingent subsidies and the significant price suppression it had found. It then addressed the impact of "[o]ther alleged causal factors".⁵³¹ 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".⁵³² 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"⁵³³ 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*.⁵³⁴ 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".⁵³⁵ 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).

⁵²⁹Panel Report, heading (k) to paras. 7.1334-7.1363.

⁵³⁰*Ibid.*, heading (i) to paras. 7.1347-7.1356.

⁵³¹*Ibid.*, heading (ii) to paras. 7.1357-7.1363.

⁵³²*Shorter Oxford English Dictionary*, 5th ed., W.R. Trumble, A. Stevenson (eds.) (Oxford University Press, 2002), Vol. 1, p. 793.

⁵³³Panel Report, para. 7.1341.

⁵³⁴*Ibid.*, para. 7.1343.

⁵³⁵See 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.⁵³⁶ 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"⁵³⁷ 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."⁵³⁸

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"⁵³⁹ "involves a genuine and substantial relationship of cause and effect between these two elements"⁵⁴⁰, and it has also required non-attribution of effects caused by other factors.⁵⁴¹ 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."⁵⁴² 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.

⁵³⁶Panel Report, para. 7.1344.

⁵³⁷*Ibid.*, para. 7.1345.

⁵³⁸*Ibid.*, para. 7.1346.

⁵³⁹Article 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*.

⁵⁴⁰Appellate Body Report, *US – Wheat Gluten*, para. 69.

⁵⁴¹Appellate Body Report, *US – Line Pipe*, para. 208.

⁵⁴²Appellate 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".⁵⁴³ 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.⁵⁴⁴ 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.⁵⁴⁵ 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.⁵⁴⁶ During the oral hearing, the United States accepted that farmers decide what to plant based on expected market prices as well as expected subsidies.⁵⁴⁷ 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".⁵⁴⁸

441. We note that the United States presented extensive evidence and arguments to the Panel in relation to expected prices and planting decisions.⁵⁴⁹ Brazil also points to several questions asked by

⁵⁴³United States' appellant's submission, para. 180. See *supra*, para. 420.

⁵⁴⁴United States' appellant's submission, paras. 154 and 155.

⁵⁴⁵Brazil's appellee's submission, para. 692.

⁵⁴⁶Brazil's response to questioning at the oral hearing.

⁵⁴⁷See also United States' further rebuttal submission to the Panel, paras. 95-97.

⁵⁴⁸United States' statement and response to questioning at the oral hearing.

⁵⁴⁹See, 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.⁵⁵⁰ The Panel Report makes it clear that the Panel specifically addressed "upland cotton planting decisions", "expected prices", and "expected market revenue".⁵⁵¹ 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.⁵⁵²

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".⁵⁵³ 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"⁵⁵⁴ 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".⁵⁵⁵ 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".⁵⁵⁶

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.⁵⁵⁷ 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

⁵⁵⁰Brazil's appellee's submission, para. 685 (referring, *inter alia*, to Brazil's response to Question 167 posed by the Panel (Panel Report, pp. I-216-217, para. 151); United States' response to Question 212 Posed by the Panel (Panel Report, p. I-360, para. 51); Question 213 Posed by the Panel (Panel Report, p. I-361)).

⁵⁵¹Panel Report, para. 7.1362.

⁵⁵²See the discussion *supra*, para. 399.

⁵⁵³United States' statement at the oral hearing.

⁵⁵⁴Panel Report, para. 7.1293.

⁵⁵⁵*Ibid.*, para. 7.1294. (original emphasis)

⁵⁵⁶*Ibid.*, para. 7.1294.

⁵⁵⁷*Ibid.*, para. 7.1294.

upland cotton producers and found that marketing loan program payments made up a significant proportion of producers' revenue.⁵⁵⁸

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.⁵⁵⁹ 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"⁵⁶⁰ 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.⁵⁶¹ 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".⁵⁶²

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".⁵⁶³ The Panel Report contains several passages suggesting that the Panel did take into account evidence of this kind. For example, the Panel

⁵⁵⁸We return to the issue of quantification of the price-contingent subsidies in section VI.A.5(f) below.

⁵⁵⁹This data corresponds with the United States' written argument that "the uncontested 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)

⁵⁶⁰Panel Report, para. 7.1294.

⁵⁶¹Ibid., para. 7.225.

⁵⁶²Appellate Body Report, *Australia – Salmon*, para. 267.

⁵⁶³United States' appellant's submission, para. 155.

considered the United States' evidence regarding expected upland cotton prices⁵⁶⁴ and set out the United States' share of world upland cotton production during the relevant period.⁵⁶⁵ 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.⁵⁶⁶

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".⁵⁶⁷ 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".⁵⁶⁸ The participants agree that these models incorporate the supply response of third countries.⁵⁶⁹ 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.⁵⁷⁰ 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

⁵⁶⁴Panel Report, para. 7.1362.

⁵⁶⁵Ibid., 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".

⁵⁶⁶Appellate Body Report, *EC – Hormones*, paras. 135 and 138.

⁵⁶⁷United States' appellant's submission, para. 237.

⁵⁶⁸Brazil's appellee's submission, paras. 793-798 (referring to Panel Report, paras. 7.1205, 7.1209, and 7.1215). (original emphasis)

⁵⁶⁹In 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.

⁵⁷⁰Panel 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 grounds⁵⁷¹ on which the Panel based its conclusion that "a causal link exists between" the price-contingent subsidies and the significant price suppression it had found⁵⁷², which the United States contests.⁵⁷³ The first reason the Panel provided for finding a "causal link"⁵⁷⁴ 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".⁵⁷⁵ The United States counters that, "absent some analysis of how U.S. cotton competes with cotton from other sources, relative sizes are meaningless."⁵⁷⁶ 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"⁵⁷⁷ was its view that the price-contingent subsidies "are directly linked to world prices for upland cotton".⁵⁷⁸ 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.⁵⁷⁹ 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".⁵⁸⁰ As a result, during the 1999-2002 marketing years, United States production and exports remained stable or increased, even though prices of

⁵⁷¹United States' appellant's submission, para. 180.

⁵⁷²Panel Report, para. 7.1355.

⁵⁷³United States' appellant's submission, para. 180.

⁵⁷⁴Panel Report, para. 7.1347.

⁵⁷⁵*Ibid.*, para. 7.1348.

⁵⁷⁶United States' appellant's submission, para. 183.

⁵⁷⁷Panel Report, para. 7.1347.

⁵⁷⁸*Ibid.*, para. 7.1349.

⁵⁷⁹*Supra*, para. 434.

⁵⁸⁰Panel Report, para. 7.1294.

United States upland cotton decreased.⁵⁸¹ The Panel found that Step 2 payments stimulate domestic and foreign demand for United States upland cotton⁵⁸² by "eliminating any positive difference between United States internal prices and international prices of upland cotton".⁵⁸³ The Panel stated that Step 2 payments "result in lower world market prices than would prevail in their absence".⁵⁸⁴ Finally, the Panel found that market loss assistance payments and counter-cyclical payments are made in response to low prices for upland cotton⁵⁸⁵ and stimulate United States production of upland cotton by reducing the "total and per unit revenue risk associated with price variability".⁵⁸⁶ The United States contends that the Panel's analysis of the price-contingent subsidies was "deficient".⁵⁸⁷ 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.⁵⁸⁸ This seems to us to support the Panel's conclusion that the effect of the price-contingent subsidies is significant price suppression.⁵⁸⁹

451. The third reason the Panel provided for finding a "causal link"⁵⁹⁰ was that "there is a discernible temporal coincidence of suppressed world market prices" and the price-contingent subsidies.⁵⁹¹ The United States describes this as "an exercise in spurious correlation".⁵⁹² 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.

⁵⁸¹Panel Report, para. 7.1296.

⁵⁸²*Ibid.*, para. 7.1299.

⁵⁸³*Ibid.*, para. 7.1298.

⁵⁸⁴*Ibid.*, para. 7.1299.

⁵⁸⁵*Ibid.*, para. 7.1301.

⁵⁸⁶*Ibid.*, para. 7.1302 and footnote 1410 to para. 7.1302.

⁵⁸⁷United States' appellant's submission, para. 185.

⁵⁸⁸Panel Report, para. 7.1291, 7.1295-7.1296, 7.1299, and 7.1308-7.1311.

⁵⁸⁹We 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.

⁵⁹⁰Panel Report, para. 7.1347.

⁵⁹¹*Ibid.*, para. 7.1351.

⁵⁹²United States' appellant's submission, para. 208.

452. The fourth reason the Panel provided for finding a "causal link"⁵⁹³ was the "divergence between United States producers' total costs of production and revenue from sales of upland cotton since 1997".⁵⁹⁴ The United States argues that the Panel should have examined variable rather than total costs⁵⁹⁵ 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".⁵⁹⁶

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".⁵⁹⁷ 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".⁵⁹⁸ 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"⁵⁹⁹ 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.⁶⁰⁰ 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".⁶⁰¹

⁵⁹³Panel Report, para. 7.1347.

⁵⁹⁴*Ibid.*, para. 7.1353. (footnote omitted)

⁵⁹⁵United States' appellant's submission, para. 215.

⁵⁹⁶Panel Report, para. 7.1353.

⁵⁹⁷*Ibid.*, para. 7.1354.

⁵⁹⁸*Ibid.*, para. 7.1353.

⁵⁹⁹*Ibid.*, para. 7.1357.

⁶⁰⁰United States' appellant's submission, para. 138.

⁶⁰¹*Supra*, paras. 440-445.

455. The United States also argues that United States upland cotton exports increased during 1998-2002⁶⁰² because textile imports increased in the same period, leading to a decline in the use of cotton by domestic mills.⁶⁰³ The Panel regarded this factor as "concerning support, rather than suppression, of world cotton prices".⁶⁰⁴ 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.⁶⁰⁵

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 2001.⁶⁰⁶ 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.⁶⁰⁷ 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.⁶⁰⁸ 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)".⁶⁰⁹ The Panel pointed to evidence on the record confirming that marketing loan program payments and Step 2 payments "offset" declines in market prices.⁶¹⁰ 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".⁶¹¹ However, the

⁶⁰²The 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)

⁶⁰³United States' appellant's submission, para. 211.

⁶⁰⁴Panel Report, para. 7.1359.

⁶⁰⁵In this regard, see *supra*, para. 437 and *infra*, para. 457.

⁶⁰⁶Panel Report, paras. 7.1358, 7.1360, and 7.1361.

⁶⁰⁷In 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))

⁶⁰⁸Panel Report, para. 7.1358.

⁶⁰⁹*Ibid.*, para. 7.1360.

⁶¹⁰*Ibid.*, footnote 1477 to para. 7.1360.

⁶¹¹*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".⁶¹²

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".⁶¹³

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:

⁶¹²Panel Report, para. 7.1361.

⁶¹³*Ibid.*, para. 7.1363.

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.⁶¹⁴

[W]hile we do not believe that it is strictly necessar[y] 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.⁶¹⁵

In addition, the Panel made statements regarding the amount of individual price-contingent subsidies, namely marketing loan program payments and Step 2 payments.⁶¹⁶

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.⁶¹⁷ 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.⁶¹⁸ 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".⁶¹⁹ 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.⁶²⁰

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

⁶¹⁴Panel Report, para. 7.1308.

⁶¹⁵*Ibid.*, para. 7.1349.

⁶¹⁶"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)

⁶¹⁷United 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.

⁶¹⁸United States' appellant's submission, para. 242.

⁶¹⁹*Ibid.*, para. 264.

⁶²⁰*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.⁶²¹ 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*.⁶²² The Panel did so in this dispute⁶²³, 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.⁶²⁴ 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*.⁶²⁵ However, the United States identifies Part V as providing relevant context for the

⁶²¹Supra, para. 432.

⁶²²As 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)

⁶²³Panel Report, paras. 7.1120 and 7.1154.

⁶²⁴United States' appellant's submission, para. 246.

⁶²⁵Ibid., para. 258, as confirmed during the oral hearing.

interpretation of Articles 5(c) and 6.3(c) of the *SCM Agreement*.⁶²⁶ 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.⁶²⁷ 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)⁶²⁸, but Annex V also refers to other information.⁶²⁹ 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

⁶²⁶United States' appellant's submission, para. 260.

⁶²⁷In 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)

⁶²⁸United States' appellant's submission, paras. 247-252.

⁶²⁹For 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".

product in the relevant market when analyzing whether the effect of a subsidy is significant price 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"⁶³⁰, 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.⁶³¹

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"⁶³² 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".⁶³³ 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"⁶³⁴ 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.⁶³⁵ 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.⁶³⁶

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.⁶³⁷ As for

⁶³⁰*Supra*, para. 459.

⁶³¹Panel Report, paras. 7.596 and 7.641; United States' response to questions posed by the Panel (Panel Report, p. I-126, para. 211).

⁶³²United States' appellant's submission, para. 269.

⁶³³*Ibid.*, para. 268.

⁶³⁴Panel Report, para. 7.646.

⁶³⁵*Ibid.*, "Attachment to Section VII:D", paras. 7.634-7.647.

⁶³⁶Table 3 of Annex 2.

⁶³⁷Panel 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'".⁶³⁸

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).⁶³⁹ 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*.⁶⁴⁰

472. As we have already noted⁶⁴¹, 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*.

⁶³⁸Panel Report, footnote 258 to para. 7.197. See also *ibid.*, footnotes 1339 and 1340 to para. 7.1225.

⁶³⁹United States' appellant's submission, paras. 304 and 305 (quoting Appellate Body Report, *US – Softwood Lumber IV*, para. 142).

⁶⁴⁰Appellate 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.

⁶⁴¹*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 2001.⁶⁴² 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"⁶⁴³ to the year "for which the payment is made"⁶⁴⁴, 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"⁶⁴⁵, 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".⁶⁴⁶ The Panel was established in marketing year 2002⁶⁴⁷ 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.⁶⁴⁸

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

⁶⁴²See *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)

⁶⁴³United States' appellant's submission, para. 284.

⁶⁴⁴The 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".

⁶⁴⁵United States' appellant's submission, para. 291.

⁶⁴⁶*Ibid.*, para. 278.

⁶⁴⁷The 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)

⁶⁴⁸United 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.⁶⁴⁹

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'.⁶⁵⁰ (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.⁶⁵¹ 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.⁶⁵²

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.⁶⁵³ 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

⁶⁴⁹Although 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).

⁶⁵⁰The 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".

⁶⁵¹The 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.

⁶⁵²The French and Spanish versions of Article 6.2 also use the present perfect tense. See *supra*, footnote 650.

⁶⁵³Article 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".⁶⁵⁴

479. The United States supports its arguments regarding the "allocation" of "recurring" and "non-recurring" subsidies by referring to several sources.⁶⁵⁵ The United States submits that "the Appellate Body has acknowledged that hon-recurring' subsidies may be allocated over time"⁶⁵⁶, 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".⁶⁵⁷

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*⁶⁵⁸, 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"

subsidies. In any event, as the Panel noted, the "effect" of a subsidy cannot be equated with the "benefit" of a subsidy.⁶⁵⁹

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 2002⁶⁶⁰ "is significant price suppression ... in the period MY 1999-2002".⁶⁶¹ 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.⁶⁶²

⁶⁵⁴Panel Report, para. 7.1199.

⁶⁵⁵United 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 Countermeasures, 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 Countermeasures, G/SCM/W/415/Rev.2 (15 May 1998), Recommendation 1 and paras. 1-12.

⁶⁵⁶United States' appellant's submission, para. 283.

⁶⁵⁷Appellate Body Report, *US – Lead and Bismuth II*, para. 62.

⁶⁵⁸The title of Annex IV of the *SCM Agreement* is "Calculation of the Total Ad Valorem Subsidization (Paragraph 1(a) of Article 6)". (footnote omitted)

⁶⁵⁹Panel Report, para. 7.1179.

⁶⁶⁰*Ibid.*, para. 7.1108.

⁶⁶¹*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.

⁶⁶²*Ibid.*, para. 7.1192.

484. For this reason, the Panel examined the price-contingent subsidies for marketing years 1999 to 2002 as a group⁶⁶³, and its finding of significant price suppression in marketing years 1999 to 2002⁶⁶⁴ 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.⁶⁶⁵ 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".⁶⁶⁶

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*⁶⁶⁷, 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 Article 5(c) of the *SCM Agreement*⁶⁶⁸, 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*.⁶⁶⁹

[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.⁶⁷⁰

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 Article 5(c) of the

SCM Agreement.⁶⁷¹ 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 subsidizing Member has caused serious prejudice to the interests of another Member within the meaning of Article 5(c).⁶⁷² 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).⁶⁷³

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*".⁶⁷⁴ 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.⁶⁷⁵ 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*.⁶⁷⁶ 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 above⁶⁷⁷ would stand, without endorsement or rejection by the Appellate Body.

⁶⁶³Panel Report, para. 7.1290.

⁶⁶⁴*Ibid.*, para. 7.1416.

⁶⁶⁵*Supra*, para. 482.

⁶⁶⁶United States' appellant's submission, para. 278.

⁶⁶⁷Panel Report, paras. 7.1355-7.1356 and 7.1363.

⁶⁶⁸*Ibid.*, paras. 7.1395 and 8.1(g)(i).

⁶⁶⁹*Ibid.*, para. 7.1390.

⁶⁷⁰*Ibid.*, para. 7.1391.

⁶⁷¹Panel Report, paras. 7.1395 and 8.1(g)(i).

⁶⁷²*Ibid.*, para. 7.1390.

⁶⁷³*Ibid.*, para. 7.1391.

⁶⁷⁴United 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).

⁶⁷⁵Brazil's appellee's submission, para. 1084.

⁶⁷⁶Panel Report, paras. 7.1395 and 8.1(g)(i).

⁶⁷⁷*Supra*, para. 485.

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 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'."⁶⁷⁸ In fact, the Panel based its reasoning in this regard on the ordinary meaning of "significant"⁶⁷⁹, explaining that the "significance" of price suppression could, depending on the circumstances, have both quantitative and qualitative aspects.⁶⁸⁰ 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).⁶⁸¹ 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".⁶⁸² 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.⁶⁸³ In addition, we note that the Panel articulated a basic rationale for its conclusions in this regard.⁶⁸⁴ 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

⁶⁷⁸United States' appellant's submission, para. 330.

⁶⁷⁹Panel Report, para. 7.1325 (referring to *The New Shorter Oxford English Dictionary* (1993)).

⁶⁸⁰"The 'significance' of any degree of price suppression ... may not solely depend upon a given level of numeric significance". (Panel Report, para. 7.1329)

⁶⁸¹Panel Report, paras. 7.1316-7.1333.

⁶⁸²United States' appellant's submission, para. 326.

⁶⁸³*Supra*, para. 473.

⁶⁸⁴Panel 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)

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 suppression⁶⁸⁵ and that the Panel "never explained why it did not analyze the farmer's planting decision and the use of expected prices".⁶⁸⁶ 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.⁶⁸⁷ As we have already explained, the Panel did address the "planting decision" and "expected prices"⁶⁸⁸, 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).⁶⁸⁹

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"⁶⁹⁰; and (ii) "why any price suppression that it found meant that there was serious prejudice to the interests of Brazil".⁶⁹¹

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.⁶⁹²

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,

⁶⁸⁵United States' appellant's submission, para. 325.

⁶⁸⁶*Ibid.*, para. 324.

⁶⁸⁷Panel 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.

⁶⁸⁸*Supra*, para. 441.

⁶⁸⁹*Supra*, para. 433.

⁶⁹⁰United States' appellant's submission, para. 328.

⁶⁹¹*Ibid.*, para. 329.

⁶⁹²It 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".

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 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*")⁶⁹³, 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*.⁶⁹⁴ 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.⁶⁹⁵ The principal

⁶⁹³See *supra*, footnote 18.

⁶⁹⁴See *supra*, para. 488.

⁶⁹⁵The 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)

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"⁶⁹⁶, and put forward evidence regarding increases in 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.⁶⁹⁷

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.⁶⁹⁸ 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 disciplines⁶⁹⁹ and logical inconsistencies in the United States' arguments.⁷⁰⁰ 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.⁷⁰¹

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*".⁷⁰²

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*.⁷⁰³ 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.⁷⁰⁴ However, the

⁶⁹⁶Panel Report, para. 7.1424. (footnote omitted)

⁶⁹⁷*Ibid.*, para. 7.1425.

⁶⁹⁸*Ibid.*, paras. 7.1438-7.1450, and 7.1455-7.1463.

⁶⁹⁹*Ibid.*, paras. 7.1451-7.1453.

⁷⁰⁰*Ibid.*, footnote 1527 to para. 7.1451.

⁷⁰¹*Ibid.*, para. 7.1464. (underlining added)

⁷⁰²*Ibid.*, para. 7.1465. (footnote omitted)

⁷⁰³Brazil's other appellant's submission, para. 264.

⁷⁰⁴*Ibid.*, para. 275.

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 *production*, as the Panel found.⁷⁰⁵ 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.⁷⁰⁶ 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.⁷⁰⁷ 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.⁷⁰⁸

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 subsidies⁷⁰⁹ 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.⁷¹⁰

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.⁷¹¹ 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

⁷⁰⁵Brazil's other appellant's submission, paras. 276-277.

⁷⁰⁶*Ibid.*, paras. 275-280.

⁷⁰⁷*Ibid.*, paras. 281-288.

⁷⁰⁸*Ibid.*, paras. 289-294.

⁷⁰⁹That is, marketing loan program payments, Step 2 payments, market loss assistance payments and counter-cyclical payments.

⁷¹⁰Brazil's other appellant's submission, paras. 296-315.

⁷¹¹Indeed (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)

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:3.⁷¹² The United States rebuts Brazil's arguments 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.⁷¹³ 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.⁷¹⁴ 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).⁷¹⁵

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*.⁷¹⁶ 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.⁷¹⁷

⁷¹²United States' appellee's submission, para. 153.

⁷¹³*Ibid.*, paras. 154-156.

⁷¹⁴*Ibid.*, para. 161.

⁷¹⁵*Ibid.*, paras. 163-165.

⁷¹⁶Benin and Chad's third participants' submission, paras. 75-79.

⁷¹⁷*Ibid.*, paras. 80-91.

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:

- ...
(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 commodity¹⁷ 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.

¹⁷ 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).⁷¹⁸ 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".⁷¹⁹ 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.⁷²⁰

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*.

⁷¹⁸On the relationship between Articles 5(c) and 6.3 of the *SCM Agreement*, see *supra*, paras. 485-488.

⁷¹⁹Panel Report, para. 7.1464. (emphasis added)

⁷²⁰*Ibid.*, para. 7.1465.

507. We observe with regard to the interpretation of the phrase "world market share" in Article 6.3(d) that, above⁷²¹, 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.⁷²²

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*

⁷²¹*Supra*, para. 496.

⁷²²Appellate Body Report, *US – Wool Shirts and Blouses*, p. 19, DSR 1997:I, 323 at 340.

might offer at best some degree of "guidance" on that issue, it would not affect the resolution of this particular dispute.⁷²³ 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*.⁷²⁴ This condition is not met.

⁷²³We 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)

⁷²⁴Benin 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 Panel⁷²⁵, the program pursuant to which Step 2 payments are granted has been authorized since 1990 under successive legislation, including the FAIR Act of 1996⁷²⁶ and the FSRI Act of 2002.⁷²⁷ Under the program, marketing certificates or cash payments (collectively referred to by the Panel as "user marketing (Step 2) payments")⁷²⁸ 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".⁷²⁹ 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^[730] to participate in the upland cotton user marketing certificate program.⁷³¹

⁷²⁵Panel Report, para. 7.209.

⁷²⁶Section 136 of the FAIR Act of 1996, reproduced in Exhibits BRA-28 and US-22.

⁷²⁷Section 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.

⁷²⁸The 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))

⁷²⁹7 CFR Section 1427.103(a).

⁷³⁰Additional information about the CCC is provided, *infra*, footnote 859; see also Panel Report, para. 7.702.

⁷³¹7 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.⁷³²

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."⁷³³ 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".⁷³⁴ 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)".⁷³⁵ 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".⁷³⁶ 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".⁷³⁷

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

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*.⁷³⁸ 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".⁷³⁹

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".⁷⁴⁰ 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*.⁷⁴¹ 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*".⁷⁴² 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*".⁷⁴³

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*

⁷³⁸Panel 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)

⁷³⁹*Ibid.*, para. 7.1019.

⁷⁴⁰*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)).

⁷⁴¹*Ibid.*, para. 7.1023.

⁷⁴²*Ibid.*, para. 7.1024.

⁷⁴³*Ibid.*

⁷³²7 CFR Section 1427.104(a)(2).

⁷³³Panel Report, para. 7.210.

⁷³⁴*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)

⁷³⁵*Ibid.*, para. 7.211.

⁷³⁶*Ibid.*

⁷³⁷*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).

Agreement may depend upon the provisions of the *Agreement on Agriculture*.⁷⁴⁴ 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".⁷⁴⁵ The Panel described the situations in which, in its view, Article 21.1 of the *Agreement on Agriculture* applies⁷⁴⁶, 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*".⁷⁴⁷ The Panel concluded that "none of the situations" it described arises in this dispute from the relevant provisions in the *Agreement on Agriculture*.⁷⁴⁸

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*.⁷⁴⁹ 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*".⁷⁵⁰ 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*.⁷⁵¹

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".⁷⁵² Accordingly, the

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*.⁷⁵³

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*".⁷⁵⁴ 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.⁷⁵⁵

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".⁷⁵⁶

⁷⁴⁴Panel Report, para. 7.1034. (footnote omitted)

⁷⁴⁵*Ibid.*, para. 7.1036.

⁷⁴⁶*Ibid.*, para. 7.1038. See *infra*, para. 532.

⁷⁴⁷*Ibid.*, para. 7.1041. (footnote omitted)

⁷⁴⁸*Ibid.*, para. 7.1039.

⁷⁴⁹*Ibid.*, para. 7.1052.

⁷⁵⁰*Ibid.*, para. 7.1056.

⁷⁵¹*Ibid.*, para. 7.1058. (original emphasis)

⁷⁵²*Ibid.*, para. 7.1071.

⁷⁵³Panel Report, para. 7.1071.

⁷⁵⁴*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)

⁷⁵⁵*Ibid.*, paras. 7.1085-7.1086. (original emphasis)

⁷⁵⁶*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*".⁷⁵⁷ 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*".⁷⁵⁸

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*.⁷⁵⁹ 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*.⁷⁶⁰ 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.⁷⁶¹ 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.⁷⁶² 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".⁷⁶³ 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

⁷⁵⁷Panel Report, para. 7.1097. (footnote omitted)

⁷⁵⁸*Ibid.*, para. 7.1098.

⁷⁵⁹United States' appellant's submission, paras. 429-430.

⁷⁶⁰*Ibid.*, para. 434.

⁷⁶¹*Ibid.*, para. 435.

⁷⁶²*Ibid.*, paras. 431-432.

⁷⁶³Brazil'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).⁷⁶⁴

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.⁷⁶⁵ 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.⁷⁶⁶ 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 1994.⁷⁶⁷

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.⁷⁶⁸ 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*.⁷⁶⁹

⁷⁶⁴Brazil's appellee's submission, para. 867.

⁷⁶⁵*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.

⁷⁶⁶Brazil's appellee's submission, para. 861.

⁷⁶⁷*Ibid.*, paras. 863-865.

⁷⁶⁸Panel Report, para. 7.1082.

⁷⁶⁹*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.⁷⁷⁰

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*.⁷⁷¹

⁷⁷⁰The *SCM Agreement* is among the Multilateral Trade Agreements in Annex 1A to the *WTO Agreement*.

⁷⁷¹Panel 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".⁷⁷² 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.⁷⁷³ 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.

⁷⁷²Appellate Body Report, *EC – Bananas III*, para. 155. (See also Appellate Body Report, *Chile – Price Band System*, para. 186)

⁷⁷³Certain 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."⁷⁷⁴

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".⁷⁷⁵ The United States has acknowledged that the domestic users of United States cotton that receive Step 2 payments include textile mills.⁷⁷⁶ 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*.⁷⁷⁷

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.

⁷⁷⁴United States' appellant's submission, para. 428.

⁷⁷⁵See *supra*, para. 514.

⁷⁷⁶United States' response to questioning at oral hearing.

⁷⁷⁷In 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.⁷⁷⁸

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.⁷⁷⁹ 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

⁷⁷⁸Panel Report, para. 7.1059.

⁷⁷⁹United 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".⁷⁸⁰ Rather than "a cotton subsidy", it would become a "textile subsidy".⁷⁸¹ 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".⁷⁸² 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"⁷⁸³—on the use of domestic over imported goods.⁷⁸⁴

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 annual or final bound commitment level specified in its Schedule. It does not say that compliance

⁷⁸⁰United States' appellant's submission, para. 428.

⁷⁸¹*Ibid.* (emphasis omitted)

⁷⁸²Brazil's appellee's submission, footnote 1242 to para. 854. (original emphasis)

⁷⁸³Appellate Body Report, *Canada – Autos*, para. 123.

⁷⁸⁴See Panel Report, para. 7.1067.

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.⁷⁸⁵

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 1994.⁷⁸⁶ 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

⁷⁸⁵Panel Report, para. 7.1058. (original emphasis)

⁷⁸⁶Appellate Body Report, *EC – Bananas III*, para. 153.

products".⁷⁸⁷ 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".⁷⁸⁸ 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'".⁷⁸⁹ 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".⁷⁹⁰ 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".⁷⁹¹

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

use of domestic over imported goods within the meaning of Article 3.1(b)" of that Agreement.⁷⁹² 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.⁷⁹³

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.⁷⁹⁴

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*.⁷⁹⁵ 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.⁷⁹⁶

⁷⁸⁷Appellate Body Report, *EC – Bananas III*, para. 157.

⁷⁸⁸*Ibid.*

⁷⁸⁹Appellate 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*.

⁷⁹⁰Appellate 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:I, 3 at 21; Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 12, DSR 1996:I, 97 at 106; and Appellate Body Report, *India – Patents (US)*, para. 45). (original emphasis)

⁷⁹¹Panel Report, para. 7.1071.

⁷⁹²Panel Report, para. 7.1082.

⁷⁹³*Ibid.*, para. 7.1086.

⁷⁹⁴See also *ibid.*, paras. 7.209-7.211.

⁷⁹⁵*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)

⁷⁹⁶*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*.⁷⁹⁷

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*.⁷⁹⁸ 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*.⁷⁹⁹

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*.⁸⁰⁰ 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*.⁸⁰¹ 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"⁸⁰² or "where the condition to export can be derived by necessary implication from the words actually used in the measure".⁸⁰³

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.⁸⁰⁴

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)".⁸⁰⁵ 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".⁸⁰⁶

560. Having found that Step 2 payments to exporters are mandatory when certain market conditions exist⁸⁰⁷, 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*.⁸⁰⁸

⁷⁹⁷Panel Report, para. 7.673. The order of analysis was not an issue on appeal.

⁷⁹⁸*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)

⁷⁹⁹*Ibid.*, para. 7.697.

⁸⁰⁰*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).

⁸⁰¹*Ibid.*, para. 7.702.

⁸⁰²*Ibid.*, (relying on Appellate Body Report, *Canada – Aircraft*, para. 167).

⁸⁰³*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).

⁸⁰⁴Panel Report, paras. 7.734 and 7.735.

⁸⁰⁵*Ibid.*, para. 7.732.

⁸⁰⁶*Ibid.*, para. 7.739 and footnote 907 thereto (relying on Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 119).

⁸⁰⁷*Ibid.*, paras. 7.7745 and 7.746.

⁸⁰⁸*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".⁸⁰⁹

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*".⁸¹⁰ 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*".⁸¹¹

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*.⁸¹²

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).⁸¹³ 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

⁸⁰⁹Panel Report, para. 7.749.

⁸¹⁰*Ibid.*, para. 7.760.

⁸¹¹*Ibid.*, para. 7.761.

⁸¹²United States' appellant's submission, para. 516(6).

⁸¹³*Ibid.*, para. 442.

are also available to domestic users of United States upland cotton.⁸¹⁴ 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.⁸¹⁵ 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.⁸¹⁶ These situations are mutually exclusive because the same bale of cotton cannot be both opened for domestic use and exported.⁸¹⁷ 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.⁸¹⁸

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.⁸¹⁹ 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.⁸²⁰

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*.

⁸¹⁴United 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))

⁸¹⁵Brazil's appellee's submission, para. 872.

⁸¹⁶*Ibid.*, para. 888.

⁸¹⁷*Ibid.*

⁸¹⁸Brazil 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)

⁸¹⁹Brazil's appellee's submission, para. 886.

⁸²⁰*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 fact⁴, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I⁵;

⁴ 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.

⁵ 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*⁸²¹; 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

⁸²¹See, 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*.⁸²²

572. The Appellate Body has indicated, in this regard, that the ordinary meaning of "contingent" is "conditional" or "dependent"⁸²³ 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.⁸²⁴ 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*".⁸²⁵ 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".⁸²⁶

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)

⁸²²Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 192.

⁸²³Appellate Body Report, *Canada – Aircraft*, para. 166.

⁸²⁴Appellate Body Report, *Canada – Aircraft (Article 21.5 – Brazil)*, para. 47. See also Appellate Body Report, *Canada – Aircraft*, para. 166.

⁸²⁵Appellate Body Report, *Canada – Aircraft (Article 21.5 – Brazil)*, para. 47 (quoting Appellate Body Report, *Canada – Aircraft*, para. 171).

⁸²⁶The 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)

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 CCC⁸²⁷ to participate in the upland cotton user marketing certificate program.⁸²⁸

"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."⁸²⁹

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".⁸³⁰ 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".⁸³¹ 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".⁸³²

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.⁸³³ 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.⁸³⁴

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

⁸²⁷Additional information about the CCC is provided, *infra*, footnote 859; see also Panel Report, para. 7.702.

⁸²⁸7 CFR Section 1427.104(a)(2).

⁸²⁹7 CFR Section 1427.103(a). (emphasis added)

⁸³⁰7 CFR Section 1427.108(d).

⁸³¹Panel Report, para. 7.734.

⁸³²See Appellate Body Report, *Canada – Aircraft (Article 21.5 – Brazil)*, para. 47.

⁸³³United States' appellant's submission, para. 442.

⁸³⁴*Ibid.*, para. 454.

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.⁸³⁵ 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.⁸³⁶ As we have seen, an eligible exporter must be "[a] person, including a producer or a cooperative marketing association ... regularly engaged in selling eligible upland cotton for *exportation* from the United States".⁸³⁷ 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".⁸³⁸ 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.⁸³⁹ 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.⁸⁴⁰ 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)".⁸⁴¹

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.⁸⁴² The Panel's reasoning is consistent with the approach taken by the

⁸³⁵Panel Report, para. 7.709.

⁸³⁶*Ibid.*, paras. 7.721-7.723.

⁸³⁷7 CFR Section 1427.104(a)(2). (emphasis added)

⁸³⁸7 CFR Section 1427.104(a)(1).

⁸³⁹United States' response to questioning at oral hearing. 7 CFR Section 1427.103(a).

⁸⁴⁰Panel Report, para. 7.727.

⁸⁴¹*Ibid.*, para. 7.732.

⁸⁴²*Ibid.*, para. 7.739.

Appellate Body in *US – FSC (Article 21.5 – EC)*.⁸⁴³ 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 asserted that, as the tax exemption was available in both circumstances, it was "export-neutral".⁸⁴⁴ 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.⁸⁴⁵

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".⁸⁴⁶ 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.⁸⁴⁷ 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.⁸⁴⁸

⁸⁴³The 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)

⁸⁴⁴Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 110.

⁸⁴⁵*Ibid.*

⁸⁴⁶*Ibid.*, para. 115.

⁸⁴⁷*Ibid.*, para. 120.

⁸⁴⁸*Ibid.*, para. 119. (original emphasis; footnote omitted)

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.⁸⁴⁹ 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*.⁸⁵⁰ In that dispute, the complaining parties argued that the provision of milk to exporters/processors under various mechanisms (described as "special milk classes") constituted 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".⁸⁵¹ 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".⁸⁵² 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.⁸⁵³ 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.⁸⁵⁴ 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.⁸⁵⁵ 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

⁸⁴⁹See, *supra*, para. 577.

⁸⁵⁰United States' appellant's submission, paras. 444-445 (referring to Panel Report, *Canada – Dairy*, para. 7.41 and footnote 496 to para. 7.124).

⁸⁵¹Panel Report, *Canada – Dairy*, para. 7.41.

⁸⁵²Panel Report, para. 7.718.

⁸⁵³Brazil's appellee's submission, paras. 898-899.

⁸⁵⁴See *supra*, para. 577.

⁸⁵⁵Panel Report, para. 7.734.

payments to exporters of United States upland cotton are "conditional upon export performance" or "dependent for their existence on export performance".⁸⁵⁶ 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*.

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*⁸⁵⁷, 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*.⁸⁵⁸ 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

⁸⁵⁶See Appellate Body Report, *Canada – Aircraft (Article 21.5 – Brazil)*, para. 47.

⁸⁵⁷See *supra*, para. 571.

⁸⁵⁸As 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)

institutions. The third type, the SCGP, applies when credit is extended by the exporter to the purchaser of United States agricultural products.⁸⁵⁹

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 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".⁸⁶⁰

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*,

⁸⁵⁹These 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.

⁸⁶⁰Panel Report, para. 7.242.

from actions based on Articles 3.1(a) and 3.2 of the *SCM Agreement*.⁸⁶¹ Brazil also argued that the three programs violate Articles 3.1(a) and 3.2 of the *SCM Agreement*.⁸⁶²

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".⁸⁶³ 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 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.⁸⁶⁴

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".⁸⁶⁵ The Panel then stated that Article 10.1 "covers any subsidy contingent on export performance that is not listed in Article 9.1".⁸⁶⁶ 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.⁸⁶⁷ 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".⁸⁶⁸

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*.⁸⁶⁹

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 were not only eligible under the programs, but that export credit guarantees were in fact received in connection with exports of those products.⁸⁷⁰ "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*.⁸⁷¹

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*".⁸⁷² In addition, the Panel found that "the United States has applied export credit guarantees constituting export subsidies within the

⁸⁶¹Panel Report, para. 7.765.

⁸⁶²Ibid., para. 7.765.
⁸⁶³United States' first written submission to the Panel, para. 160 (quoted in Panel Report, para. 7.770).
⁸⁶⁴Panel Report, para. 7.772.
⁸⁶⁵Ibid., para. 7.788.

⁸⁶⁶Ibid., para. 7.796.
⁸⁶⁷Ibid., para. 7.797.
⁸⁶⁸Ibid., para. 7.803.
⁸⁶⁹Panel Report, para. 7.867.
⁸⁷⁰Ibid., 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))

⁸⁷¹The 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))

⁸⁷²Panel Report, para. 7.875. (original emphasis)

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).⁸⁷³ 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".⁸⁷⁴ 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*".⁸⁷⁵

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".⁸⁷⁶ This argument was rejected by the 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".⁸⁷⁷ 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'".⁸⁷⁸ The Panel also rejected the United States' arguments based on subsequent practice and the drafting history.⁸⁷⁹ 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".⁸⁸⁰

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".⁸⁸¹

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)(ii) 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*.⁸⁸²

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*.⁸⁸³ 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.⁸⁸⁴ 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

⁸⁷³Panel Report, para. 7.881.

⁸⁷⁴*Ibid.*

⁸⁷⁵*Ibid.*, para. 7.896.

⁸⁷⁶*Ibid.*, para. 7.900.

⁸⁷⁷*Ibid.*, para. 7.901.

⁸⁷⁸*Ibid.*, para. 7.912. (footnote omitted)

⁸⁷⁹*Ibid.*, paras. 7.928-7.944.

⁸⁸⁰*Ibid.*, para. 7.929. (footnotes omitted)

⁸⁸¹Panel 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)

⁸⁸²*Ibid.*, paras. 7.947 and 7.948. (footnote omitted)

⁸⁸³United States' appellant's submission, para. 341.

⁸⁸⁴*Ibid.*, para. 346.

agreement on such disciplines", they must provide export credit guarantees "only in conformity therewith".⁸⁸⁵ 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 10.⁸⁸⁶

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.⁸⁸⁷ 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.⁸⁸⁸ 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 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*.⁸⁸⁹

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 10.2.⁸⁹⁰ The text of Article 10.2 establishes two obligations, but does not provide an exception.⁸⁹¹

⁸⁸⁵ Quoting Article 10.2 of the *Agreement on Agriculture*.

⁸⁸⁶ United States' appellant's submission, paras. 349 and 358.

⁸⁸⁷ *Ibid.*, paras. 367-380.

⁸⁸⁸ *Ibid.*, paras. 384-385.

⁸⁸⁹ *Ibid.*, para. 391.

⁸⁹⁰ Brazil's appellee's submission, paras. 905-906.

⁸⁹¹ *Ibid.*, para. 912.

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.⁸⁹² 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.⁸⁹³ Brazil, furthermore, disagrees with the United States' assertion that the Panel's interpretation is an "assault" on international food security.⁸⁹⁴ 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 10.1.⁸⁹⁵

603. In addition, Brazil disagrees with the conclusions drawn by the United States from the negotiating history of the *Agreement on Agriculture*.⁸⁹⁶ Brazil also rejects the United States' contention that the Panel's reading of Article 10.2 is "manifestly unreasonable".⁸⁹⁷ 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.⁸⁹⁸

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.⁸⁹⁹ Before the Panel, the European Communities submitted that Article 10.2

⁸⁹² Brazil's appellee's submission, paras. 951-952.

⁸⁹³ *Ibid.*, para. 953.

⁸⁹⁴ United States' appellant's submission, para. 350.

⁸⁹⁵ Brazil's appellee's submission, para. 940.

⁸⁹⁶ *Ibid.*, para. 975.

⁸⁹⁷ *Ibid.*, paras. 926-934 (referring to the United States' appellant's submission, para. 384).

⁸⁹⁸ *Ibid.*, paras. 977-978.

⁸⁹⁹ 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.

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 apply⁹⁰⁰; 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?⁹⁰¹

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 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.

⁹⁰⁰Panel Report, para. 7.781.

⁹⁰¹A 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.

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".⁹⁰² 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".⁹⁰³

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 10.2.⁹⁰⁴ 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".⁹⁰⁵ 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.⁹⁰⁶ 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.

⁹⁰²Panel Report, para. 7.903. (footnote omitted)

⁹⁰³*Ibid.*, para. 7.904.

⁹⁰⁴*Ibid.*, para. 7.909.

⁹⁰⁵*Ibid.*, para. 7.906.

⁹⁰⁶*Ibid.*, paras. 7.907-7.908.

611. The Panel rejected the United States' submission⁹⁰⁷ that Brazil's approach would render Article 10.2 irrelevant.⁹⁰⁸ 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".⁹⁰⁹ 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".⁹¹⁰ 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".⁹¹¹ 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.

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 9.1.⁹¹² 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.⁹¹³ 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.

⁹⁰⁷United States' first written submission to the Panel, paras. 163-165.

⁹⁰⁸Panel Report, para. 7.925.

⁹⁰⁹*Ibid.*

⁹¹⁰*Ibid.*, para. 7.926. (footnote omitted)

⁹¹¹*Shorter Oxford English Dictionary*, 5th ed., W.R. Trumble, A. Stevenson (eds.) (Oxford University Press, 2002), Vol. 1, p. 662.

⁹¹²Panel Report, para. 7.788.

⁹¹³For 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.⁹¹⁴ 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.⁹¹⁵ 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.⁹¹⁶ 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

⁹¹⁴Brazil'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.

⁹¹⁵Appellate 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.

⁹¹⁶United 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 10.1.⁹¹⁷ 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.⁹¹⁸ 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*.⁹¹⁹

619. We are unable to subscribe to the United States' arguments because we do not see Article 10.4⁹²⁰ as excluding international food aid from the scope of Article 10.1.⁹²¹ 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

⁹¹⁷United States' appellant's submission, para. 349.

⁹¹⁸*Ibid.*, para. 350.

⁹¹⁹*Ibid.*, para. 358.

⁹²⁰Article 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.

⁹²¹Brazil's appellee's submission, para. 940.

rules" but, like Article 10.2, it does not "establish any exceptions for the measures that [it] covers".⁹²² 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.⁹²³ 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'".⁹²⁴ 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'".⁹²⁵ 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".⁹²⁶ 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]."⁹²⁷ That paragraph was omitted from the "Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations"⁹²⁸, which was circulated later that month. Article 10.2 of the Draft Final Act reads as follows:

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 10.2.⁹²⁹

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".⁹³⁰ 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".⁹³¹ "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".⁹³²

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*".⁹³³ 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".⁹³⁴ Finally, the United States takes issue with the Panel's explanation that draft Article 9.3 was omitted because it was mere surplusage.⁹³⁵

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*.⁹³⁶ The Panel did not think it necessary to resort to

⁹²²Brazil's appellee's submission, para. 950.

⁹²³The 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".

⁹²⁴Panel Report, para. 7.934.

⁹²⁵*Ibid.*, para. 7.935.

⁹²⁶*Ibid.*, para. 7.936. Item (h) referred to "[e]xport credits provided by governments or their agencies on less than fully commercial terms."

⁹²⁷Panel 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)

⁹²⁸MTN.TNC/W/FA (20 December 1991), reproduced in Exhibit US-29.

⁹²⁹Panel Report, paras. 7.938-7.939.

⁹³⁰*Ibid.*, para. 7.939.

⁹³¹*Ibid.*, para. 7.940.

⁹³²*Ibid.*

⁹³³United States' appellant's submission, para. 377. (original emphasis)

⁹³⁴*Ibid.*, para. 378.

⁹³⁵*Ibid.*, para. 379.

⁹³⁶Panel Report, para. 7.933.

negotiating history for purposes of its interpretation of Article 10.2. Even if the negotiating history 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".⁹³⁷ 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".⁹³⁸ 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*.⁹³⁹ 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".⁹⁴⁰

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

⁹³⁷United States' appellant's submission, para. 383.

⁹³⁸*Ibid.*, para. 384.

⁹³⁹*Ibid.*

⁹⁴⁰*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".

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.⁹⁴¹

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.

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

⁹⁴¹The notification requirements are set out in *Notification Requirements and Formats under the WTO Agreement on Agriculture* (PC/IPL/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)

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*".⁹⁴² 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".⁹⁴³ 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*".⁹⁴⁴

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.

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

⁹⁴²United States' appellant's submission, para. 393.

⁹⁴³Ibid.

⁹⁴⁴Ibid., para. 395.

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.⁹⁴⁵ 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.⁹⁴⁶ 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*.⁹⁴⁷ This proposal was dropped in the Draft Final Act in favour of an "undertak[ing] not to provide export credits, export credit

⁹⁴⁵In 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.

⁹⁴⁶I 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*.

⁹⁴⁷Panel 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"⁹⁴⁸, 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".⁹⁴⁹ 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.⁹⁵⁰

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

⁹⁴⁸Panel Report, para. 7.938.

⁹⁴⁹United States' appellant's submission, para. 384.

⁹⁵⁰Brazil'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 guarantees⁹⁵¹, 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.⁹⁵²

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 in Article 10.3 of the *Agreement on Agriculture* in its examination of Brazil's claim under the *SCM*

⁹⁵¹ 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.I and 3.I(a)* of the *SCM Agreement* of this Report.

⁹⁵² 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. The United States emphasizes that "the burden of proof articulated in ... Article 10.3 has no application to the *SCM Agreement*".⁹⁵³ 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.⁹⁵⁴ 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.⁹⁵⁵ Finally, the United States refers to three specific instances in which the Panel allegedly applied the wrong burden of proof.⁹⁵⁶

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.⁹⁵⁷

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".⁹⁵⁸ 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*".⁹⁵⁹ 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".⁹⁶⁰

⁹⁵³ United States' appellant's submission, para. 400. (emphasis omitted)

⁹⁵⁴ *Ibid.*, para. 403.

⁹⁵⁵ *Ibid.*, para. 404.

⁹⁵⁶ *Ibid.*, paras. 405–408.

⁹⁵⁷ Brazil's appellee's submission, paras. 95 and 1015 (referring to Panel Report, para. 7.793 and footnote 948 thereto and para. 7.867).

⁹⁵⁸ Appellate Body Report, *US – Wool Shirts and Blouses*, p. 14, DSR 1997:1, 323 at 335.

⁹⁵⁹ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, para. 69.

⁹⁶⁰ *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.⁹⁶¹ (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".⁹⁶²

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".⁹⁶³ 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.⁹⁶⁴

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

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.⁹⁶⁵ 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.⁹⁶⁶ (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.⁹⁶⁷ 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*".⁹⁶⁸ 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*

⁹⁶¹Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, para. 74.

⁹⁶²*Ibid.*, para. 75.

⁹⁶³United States' appellant's submission, para. 399. (emphasis added)

⁹⁶⁴Panel Report, para. 7.868.

⁹⁶⁵Panel Report, para. 7.803.

⁹⁶⁶*Ibid.*, para. 7.867.

⁹⁶⁷See *ibid.*, paras. 7.946-7.948.

⁹⁶⁸*Ibid.*, para. 7.946 (footnote omitted)

Agriculture, to which it had referred previously in its "contextual" analysis of item (j) under the *Agreement on Agriculture*, were not applicable for purposes of its analysis under the *SCM Agreement*.⁹⁶⁹ 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 subsides 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.⁹⁷⁰ 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*.⁹⁷¹

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.⁹⁷²

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.⁹⁷³ This seems to us an extreme result. In effect, it would mean that any 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.⁹⁷⁴ (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:

⁹⁶⁹Panel Report, paras. 7.946-7.948.

⁹⁷⁰United States' appellant's submission, para. 403 (referring to Panel Report, para. 7.875).

⁹⁷¹*Ibid.*, para. 404.

⁹⁷²Panel Report, para. 7.793. (footnote omitted)

⁹⁷³As 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)

⁹⁷⁴Panel 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*.⁹⁷⁵ (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)".⁹⁷⁶ The United States assert 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*.⁹⁷⁷ Next, the United States takes issue with the Panels 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"⁹⁷⁸ 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".⁹⁷⁹ 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

⁹⁷⁵Panel Report, para. 7.875.

⁹⁷⁶United States' appellant's submission, para. 406 (referring to Panel Report, para. 7.859). (emphasis added by the United States)

⁹⁷⁷*Ibid.*, para. 406.

⁹⁷⁸*Ibid.*, para. 407 (referring to Panel Report, para. 7.857).

⁹⁷⁹*Ibid.*, para. 407 (referring to Panel Report, paras. 7.805 and 7.835).

"higher than that found in item (j)".⁹⁸⁰ 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."⁹⁸¹ 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".⁹⁸²

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 earlier⁹⁸³, 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.⁹⁸⁴ As for the Panel's rejection of the United States' submissions relating to the cohort re-estimates⁹⁸⁵, 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".⁹⁸⁶ 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.

⁹⁸⁰United States' appellant's submission, para. 407.

⁹⁸¹*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)

⁹⁸²United States' appellant's submission, para. 408.

⁹⁸³See *supra*, para. 648 (quoting Panel Report, para. 7.867).

⁹⁸⁴We 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".

⁹⁸⁵Panel Report, para. 7.853; see *supra*, para. 655.

⁹⁸⁶Brazil'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)".⁹⁸⁷ 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.⁹⁸⁸

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.⁹⁸⁹ 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.⁹⁹⁰

661. In addition, Brazil asserts that the Panel made sufficient factual findings "on the basis for"⁹⁹¹ 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

⁹⁸⁷United States' appellant's submission, para. 419.

⁹⁸⁸United States' response to questioning at the oral hearing.

⁹⁸⁹Brazil's appellee's submission, para. 1065.

⁹⁹⁰*Ibid.*, para. 99.

⁹⁹¹*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.⁹⁹²

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".⁹⁹³ 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"⁹⁹⁴, but observed that "due process requires that the legal basis of the claim be sufficiently clear to allow the appellee to respond effectively."⁹⁹⁵

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.⁹⁹⁶ It is an issue of legal characterization.⁹⁹⁷ 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.

⁹⁹²Brazil's appellee's submission, para. 101.

⁹⁹³The 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)

⁹⁹⁴Appellate Body Report, *Canada – Wheat Exports and Grain Imports*, para. 177.

⁹⁹⁵The 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)

⁹⁹⁶Appellate Body Report, *Canada – Periodicals*, p. 22, DSR 1997:1, 449 at 468.

⁹⁹⁷Appellate 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.⁹⁹⁸

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".⁹⁹⁹

666. In our view, the focus of item (j) is on the inadequacy of the premiums.¹⁰⁰⁰ 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.¹⁰⁰¹

⁹⁹⁸Panel Report, para. 7.804.

⁹⁹⁹United States' response to questioning at the oral hearing.

¹⁰⁰⁰The 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)

¹⁰⁰¹"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".¹⁰⁰² 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".¹⁰⁰³ 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.¹⁰⁰⁴

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.¹⁰⁰⁵

668. Next, the Panel examined data submitted by Brazil based on a constructed "cost" formula.¹⁰⁰⁶ This formula compares the revenues and costs of the export credit guarantee programs.¹⁰⁰⁷ The revenue column includes premiums collected, recovered principal and interest, and interest

¹⁰⁰²Panel 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)

¹⁰⁰³*Ibid.*, para. 7.842.

¹⁰⁰⁴*Ibid.*, para. 7.842. (footnotes omitted)

¹⁰⁰⁵The 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)

¹⁰⁰⁶*Ibid.*, para. 7.844.

¹⁰⁰⁷In 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.¹⁰⁰⁸ The costs column includes administrative expenses, default claims, and interest expense.¹⁰⁰⁹ The data used in this formula are "taken from the 'prior year' column of the United States government budget".¹⁰¹⁰ 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 1993-2002.¹⁰¹¹ 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".¹⁰¹² The data submitted by the United States showed that, during the same period, total revenues exceeded total expenses by approximately US\$ 630 million.¹⁰¹³

670. The Panel proceeded to compare the two sets of data.¹⁰¹⁴ 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.¹⁰¹⁵ The United States asserts that "the Panel did not make any determination about how to treat rescheduled debt".¹⁰¹⁶ 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

not treated as an outstanding claim, but rather as a new direct loan.¹⁰¹⁷ 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".¹⁰¹⁸ Thus, contrary to the United States' submission, the Panel did make a determination in respect of the treatment of rescheduled debt.¹⁰¹⁹ 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.¹⁰²⁰ 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.¹⁰²¹ 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"¹⁰²² and "the premiums are not geared toward ensuring adequacy to cover long-term operating costs and losses for the purposes of item (j)".¹⁰²³

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

¹⁰⁰⁸Brazil 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)

¹⁰⁰⁹See Table 3 in Panel Report, para. 7.845.

¹⁰¹⁰Panel Report, para. 7.846.

¹⁰¹¹*Ibid.*, paras. 7.845-7.846.

¹⁰¹²United 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.

¹⁰¹³Panel Report, para. 7.846.

¹⁰¹⁴The 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)

¹⁰¹⁵*Ibid.*, para. 7.846.

¹⁰¹⁶United States' response to questioning at the oral hearing.

¹⁰¹⁷Panel 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)

¹⁰¹⁸Panel 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)

¹⁰¹⁹We 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.

¹⁰²⁰Panel Report, para. 7.852. The Panel noted that figures submitted by Brazil showed a subsidy of US\$ 211 million, without administrative expenses.

¹⁰²¹*Ibid.*, para. 7.853.

¹⁰²²*Ibid.*, para. 7.857.

¹⁰²³*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.¹⁰²⁴ 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.¹⁰²⁵

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*".¹⁰²⁶ 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.¹⁰²⁷ 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".¹⁰²⁸ 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'

¹⁰²⁴The 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))

¹⁰²⁵Panel 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))

¹⁰²⁶*Ibid.*, para. 7.875.

¹⁰²⁷*Ibid.*, para. 7.881.

¹⁰²⁸*Ibid.*

export subsidy commitments with respect to pig meat and poultry meat in 2001.¹⁰²⁹ 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".¹⁰³⁰

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*".¹⁰³¹

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.¹⁰³² 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.¹⁰³³ 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".¹⁰³⁴ We examine Brazil's allegations, in turn, below.

¹⁰²⁹Brazil'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.

¹⁰³⁰*Ibid.*, para. 76.

¹⁰³¹Panel Report, para. 7.896.

¹⁰³²Brazil's other appellant's submission, para. 63.

¹⁰³³*Ibid.*, para. 64.

¹⁰³⁴*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 2001.¹⁰³⁵

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.¹⁰³⁶

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".¹⁰³⁷ Brazil adds that the Panel "failed to properly apply a proper interpretation of Article 10.1 to the admitted facts".¹⁰³⁸ "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".¹⁰³⁹ 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

¹⁰³⁵The 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))

¹⁰³⁶Panel Report, para. 7.881.

¹⁰³⁷Brazil's other appellant's submission, para. 204. (footnote omitted)

¹⁰³⁸*Ibid.*, para. 210.

¹⁰³⁹*Ibid.*, para. 211. (footnote omitted)

disputed fact".¹⁰⁴⁰ 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".¹⁰⁴¹

685. In addition, the United States points out that Brazil's allegation of actual circumvention related to the period July 2001 through June 2002.¹⁰⁴² 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.¹⁰⁴³ 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".¹⁰⁴⁴

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.¹⁰⁴⁵ As we explained earlier, the application of a legal rule to the specific facts of a case is an issue of legal characterization.¹⁰⁴⁶ 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.

¹⁰⁴⁰United States' appellee's submission, para. 50 (footnote omitted)

¹⁰⁴¹*Ibid.*, para. 50 (referring to Appellate Body Report, *US – Steel Safeguards*, para. 498). (original emphasis; footnote omitted)

¹⁰⁴²*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.

¹⁰⁴³The 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.

¹⁰⁴⁴United States' appellee's submission, para. 56.

¹⁰⁴⁵Brazil's response to questioning at the oral hearing; Brazil's other appellant's submission, para. 211.

¹⁰⁴⁶Appellate 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".¹⁰⁴⁷ 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.¹⁰⁴⁸

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", and that, in fiscal year 2002 it would also be true for poultry meat".¹⁰⁴⁹ 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."¹⁰⁵⁰ 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".¹⁰⁵¹ 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,

¹⁰⁴⁷Brazil's other appellant's submission, para. 205 (quoting Panel Report, para. 7.877).

¹⁰⁴⁸*Ibid.*, paras. 206-207.

¹⁰⁴⁹Panel Report, para. 7.879.

¹⁰⁵⁰*Ibid.*, para. 7.881.

¹⁰⁵¹*Ibid.*

on the one hand, to track exports under the United States' export credit guarantee programs and, on 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.¹⁰⁵² 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".¹⁰⁵³

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.¹⁰⁵⁴ 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.¹⁰⁵⁵ Second, as we noted previously¹⁰⁵⁶, 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.¹⁰⁵⁷ 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.¹⁰⁵⁸ 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

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.

¹⁰⁵²Panel Report, footnote 1060 to para. 7.880.

¹⁰⁵³*Ibid.*, para. 7.881.

¹⁰⁵⁴Appellate Body Report, *US – Section 211 Appropriations Act*, para. 343.

¹⁰⁵⁵Brazil's and the United States' responses to questioning at the oral hearing.

¹⁰⁵⁶*Supra*, para. 691.

¹⁰⁵⁷The 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.

¹⁰⁵⁸United States' appellee's submission, paras. 58-60; Brazil's statement at the oral hearing.

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.¹⁰⁵⁹

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".¹⁰⁶⁰ The Panel therefore proceeded to "examine whether an unconditional statutory legal entitlement to an export credit guarantee exists in respect of such products".¹⁰⁶¹

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."¹⁰⁶² 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".¹⁰⁶³ 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".¹⁰⁶⁴

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

¹⁰⁵⁹Panel Report, para. 7.882. (footnote omitted)

¹⁰⁶⁰*Ibid.*, para. 7.883. (emphasis added)

¹⁰⁶¹*Ibid.*, para. 7.883.

¹⁰⁶²*Ibid.*, para. 7.884. (footnote omitted)

¹⁰⁶³*Ibid.*, para. 7.886.

¹⁰⁶⁴*Ibid.*, para. 7.893.

scheduled agricultural products other than rice, in a manner which 'threatens to lead to' circumvention of export subsidy commitments".¹⁰⁶⁵ 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*.¹⁰⁶⁶

701. Brazil asserts that the Panel erred in interpreting and applying Article 10.1 of the *Agreement on Agriculture*. According to Brazil, "[by] 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".¹⁰⁶⁷ 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".¹⁰⁶⁸ 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 10.¹⁰⁶⁹ Brazil explains that "[t]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".¹⁰⁷⁰ 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".¹⁰⁷¹

¹⁰⁶⁵Panel Report, para. 7.895.

¹⁰⁶⁶*Ibid.*, para. 7.896.

¹⁰⁶⁷Brazil'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)

¹⁰⁶⁸Brazil's other appellant's submission, para. 97.

¹⁰⁶⁹*Ibid.*, paras. 98-99. The title of Article 10 is "Prevention of Circumvention of Export Subsidy Commitments".

¹⁰⁷⁰*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)

¹⁰⁷¹Brazil'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.¹⁰⁷² In contrast, "Article 10.1 of the *Agreement on Agriculture* aims at the effective *enforcement* of a Member's export subsidy *obligations*".¹⁰⁷³ 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.¹⁰⁷⁴

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.¹⁰⁷⁵ 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.¹⁰⁷⁶ 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.¹⁰⁷⁷ 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.¹⁰⁷⁸

704. The Appellate Body has explained that "under Article 10.1, it is not necessary to demonstrate *actual* 'circumvention' of 'export subsidy commitments'".¹⁰⁷⁹ It suffices that "export subsidies" are "applied in a manner which ... threatens to lead to circumvention of export subsidy commitments".¹⁰⁸⁰ 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".¹⁰⁸¹ 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.¹⁰⁸²

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".¹⁰⁸³ 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.¹⁰⁸⁴ 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.

¹⁰⁷² Brazil's other appellant's submission, para. 103.

¹⁰⁷³ *Ibid.*, para. 104. (original emphasis)

¹⁰⁷⁴ *Ibid.*, para. 105.

¹⁰⁷⁵ United States' appellee's submission, paras. 6 and 27 (referring to Brazil's other appellant's submission, para. 89).

¹⁰⁷⁶ *Ibid.*, paras. 6 and 30.

¹⁰⁷⁷ *Ibid.*, para. 32.

¹⁰⁷⁸ *Ibid.*, paras. 6 and 35.

¹⁰⁷⁹ Appellate Body Report, *US – FSC*, para. 148. (original emphasis)

¹⁰⁸⁰ *Ibid.*, para. 148.

¹⁰⁸¹ *Shorter Oxford English Dictionary*, 5th ed., W.R. Trumble, A. Stevenson (eds.) (Oxford University Press, 2002), Vol. 2, p. 3251.

¹⁰⁸² 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.)

¹⁰⁸³ 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".

¹⁰⁸⁴ 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".¹⁰⁸⁵ 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".¹⁰⁸⁶ 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.¹⁰⁸⁷ 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".¹⁰⁸⁸

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".¹⁰⁸⁹ 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.¹⁰⁹⁰

708. In concluding as it did, the Panel appears to have relied on the Appellate Body Report in *US – FSC* for guidance.¹⁰⁹¹ 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

¹⁰⁸⁵Panel Report, para. 7.883.

¹⁰⁸⁶*Ibid.*, para. 7.893.

¹⁰⁸⁷Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 85.

¹⁰⁸⁸Panel Report, para. 7.886.

¹⁰⁸⁹Brazil's other appellant's submission, para. 100.

¹⁰⁹⁰We 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.

¹⁰⁹¹In 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".¹⁰⁹² 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".¹⁰⁹³ This meant that there was "no discretionary element in the provision by the government of the FSC export subsidies".¹⁰⁹⁴ 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".¹⁰⁹⁵ 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".¹⁰⁹⁶

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 "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.

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

¹⁰⁹²Appellate Body Report, *US – FSC*, para. 149.

¹⁰⁹³*Ibid.* (original emphasis)

¹⁰⁹⁴*Ibid.*, para. 149.

¹⁰⁹⁵*Ibid.* (original emphasis)

¹⁰⁹⁶*Ibid.*, para. 149.

agricultural products eligible to receive these subsidies.¹⁰⁹⁷ 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".¹⁰⁹⁸ Brazil submits that the initial allocations by country of funds available for export credit guarantees "are repeatedly increased during the year".¹⁰⁹⁹ "The same is also true", Brazil asserts, "of product allocations, although the CCC makes relatively limited use of these".¹¹⁰⁰ 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".¹¹⁰¹

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".¹¹⁰² 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".¹¹⁰³ 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".¹¹⁰⁴

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 alone that exports of certain products are eligible for export credit guarantees is not sufficient to

¹⁰⁹⁷ Brazil's other appellant's submission, paras. 63-64 and 140.

¹⁰⁹⁸ *Ibid.*, para. 187.

¹⁰⁹⁹ *Ibid.*, para. 188.

¹¹⁰⁰ *Ibid.*, para. 189. According to Brazil, less than eight percent of allocations were product-specific in 2003.

¹¹⁰¹ Brazil's other appellant's submission, para. 191. (footnote omitted)

¹¹⁰² 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)

¹¹⁰³ Brazil's other appellant's submission, para. 195.

¹¹⁰⁴ *Ibid.*, para. 196.

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.¹¹⁰⁵ 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).¹¹⁰⁶

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.¹¹⁰⁷ 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.¹¹⁰⁸ The

¹¹⁰⁵ "Supported" products are described, *supra*, para. 676.

¹¹⁰⁶ Brazil's other appellant's submission, para. 75.

¹¹⁰⁷ *Ibid.*, para. 135 (referring to Panel Report, paras. 7.875 and 7.881).

¹¹⁰⁸ 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.¹¹⁰⁹ (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.¹¹¹⁰ In this case, the Panel did not expressly state it was exercising judicial economy.¹¹¹¹ We agree with the United States, however, that the Panel's approach can be properly characterized as an exercise of judicial economy.¹¹¹² Moreover, we believe that the Panel was within its discretion in refraining from making additional findings and it

¹¹⁰⁹Panel Report, footnote 1061 to para. 7.882.

¹¹¹⁰Appellate Body Report, *Canada – Wheat Exports and Grain Imports*, para. 133.

¹¹¹¹The Panel stated that it did not believe it "necessary to conduct any additional examination". (Panel Report, footnote 1061 to para. 7.882)

¹¹¹²The 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.¹¹¹³

719. Therefore, we reject Brazil's appeal that the Panel erred 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. *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.¹¹¹⁴ 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*.¹¹¹⁵

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

¹¹¹³Appellate Body Report, *Australia – Salmon*, para. 223. See also Appellate Body Report, *Canada – Wheat Exports and Grain Imports*, para. 133.

¹¹¹⁴Panel Report, para. 7.803.

¹¹¹⁵*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".¹¹¹⁶ 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.¹¹²⁵

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*.¹¹¹⁷

¹¹²⁵ 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*".¹¹¹⁸ 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*".¹¹¹⁹

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

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".¹¹²⁰

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 1125.¹¹²¹

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)".¹¹²² 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)".¹¹²³

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'.¹¹²⁴ 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".¹¹²⁵ Brazil further explains that the United States "could comply with its obligations under item (j) but still fail to comply with its obligations under

¹¹²⁰Panel Report, para. 6.31.

¹¹²¹*Ibid.* See *supra*, para. 722.

¹¹²²Brazil's other appellant's submission, para. 22 (quoting Panel Report, para. 6.31).

¹¹²³*Ibid.*, para. 22.

¹¹²⁴*Ibid.*, para. 23 (quoting Articles 3.2 and 21.1 of the DSU). (footnotes omitted)

¹¹²⁵*Ibid.*, para. 23.

Articles 1.1 and 3.1(a)".¹¹²⁶ 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".¹¹²⁷ 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*.¹¹²⁸

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*".¹¹²⁹ The United States explains that "[n]either item (j) nor the Illustrative List imposes obligations *per se*".¹¹³⁰ Rather, the obligations regarding export subsidies are found in Articles 3.1(a) and 3.2.¹¹³¹ 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.¹¹³²

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.¹¹³³ 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".¹¹³⁴ Finally, the United States rejects the contention that Brazil has demonstrated that the United States' export credit guarantees confer a "benefit".¹¹³⁵

¹¹²⁶Brazil's other appellant's submission, para. 23.

¹¹²⁷*Ibid.*

¹¹²⁸*Ibid.*, para. 42.

¹¹²⁹United States' appellee's submission, para. 62 (referring to Panel Report, para. 8.1(d)(i)).

¹¹³⁰*Ibid.*, para. 66

¹¹³¹*Ibid.*, para. 66. The United States submits that, under Brazil's reading, the Illustrative List would be deprived of meaning. (*Ibid.*, para. 67)

¹¹³²*Ibid.*, para. 80.

¹¹³³*Ibid.*, paras. 81-82 (referring to Panel Report, para. 6.31).

¹¹³⁴*Ibid.*, para. 85 (referring to Appellate Body Report, *US – Wool Shirts and Blouses*, p. 19, DSR 1997:1, 323 at 339). (emphasis added)

¹¹³⁵*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 1.1.¹¹³⁶ 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).¹¹³⁷ 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".¹¹³⁸

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.¹¹³⁹

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".¹¹⁴⁰ 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

¹¹³⁶Brazil's other appellant's submission, para. 22.

¹¹³⁷United States' appellee's submission, para. 66.

¹¹³⁸*Ibid.*, para. 70.

¹¹³⁹The 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)

¹¹⁴⁰Appellate 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".¹¹⁴¹

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"¹¹⁴², in connection with its finding that Brazil did not establish a *prima facie* case that the ETI Act of 2000¹¹⁴³ 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

¹¹⁴¹Appellate 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.

¹¹⁴²Brazil's other appellant's submission, para. 7.

¹¹⁴³Public 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*.¹¹⁴⁴ 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.¹¹⁴⁵

736. The United States responded that the Panel should reject Brazil's claim because Brazil failed to make a *prima facie* case.¹¹⁴⁶ 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".¹¹⁴⁷

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 2000.¹¹⁴⁸ It then observed that Brazil appeared to:

¹¹⁴⁴Panel 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*.

¹¹⁴⁵Panel 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))

¹¹⁴⁶Panel Report, para. 7.951.

¹¹⁴⁷*Ibid.*

¹¹⁴⁸*Ibid.*, para. 7.959.

... 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.¹¹⁴⁹

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".¹¹⁵⁰ In addition, the Panel rejected Brazil's reliance on Article 17.14 of the *DSU*¹¹⁵¹ 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".¹¹⁵²

738. The Panel then identified other differences between the present dispute and *US – FSC (Article 21.5 – EC)*.¹¹⁵³ 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)*.¹¹⁵⁴ 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".¹¹⁵⁵ Moreover, the Panel observed that, in a written communication to the parties after the

¹¹⁴⁹Panel Report, para. 7.961. (footnotes omitted)

¹¹⁵⁰*Ibid.*, para. 7.962.

¹¹⁵¹Article 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)

¹¹⁵²Panel Report, para. 7.967. (footnote omitted)

¹¹⁵³The 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)

¹¹⁵⁴*Ibid.*, para. 7.975.

¹¹⁵⁵*Ibid.*

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".¹¹⁵⁶

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.¹¹⁵⁷

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".¹¹⁵⁸ 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 2000¹¹⁵⁹ 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)*.¹¹⁶⁰ According to Brazil, the United States did not dispute the identity between the measures.¹¹⁶¹

¹¹⁵⁶Panel 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)

¹¹⁵⁷*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)

¹¹⁵⁸Brazil's other appellant's submission, para. 7.

¹¹⁵⁹Brazil 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. 214) See *supra*, footnote 1143.

¹¹⁶⁰Brazil's other appellant's submission, para. 221.

¹¹⁶¹*Ibid.*

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*.¹¹⁶² 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.¹¹⁶³ Brazil sees no reason why this reasoning should not also apply to submissions by a complaining Member that incorporate by reference the reasoning of another panel, as modified by the Appellate Body, addressing the exact same measure.¹¹⁶⁴

742. Brazil acknowledges that the "United States enacted legislation ... that seems to repeal most of the illegal aspects of the ETI Act of 2000".¹¹⁶⁵ Consequently, Brazil expressly states that, were we to modify the Panel's "interpretation and application of the burden of proof"¹¹⁶⁶, 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*.¹¹⁶⁷

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".¹¹⁶⁸ For that reason alone, the Appellate Body should decline to decide Brazil's appeal.¹¹⁶⁹

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

¹¹⁶²Brazil's other appellant's submission, para. 222.

¹¹⁶³Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 109.

¹¹⁶⁴In 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)

¹¹⁶⁵*Ibid.*, para. 214.

¹¹⁶⁶*Ibid.*, para. 7.

¹¹⁶⁷*Ibid.*, para. 214.

¹¹⁶⁸United 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*.

¹¹⁶⁹United States' appellee's submission, para. 100.

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.¹¹⁷⁰

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 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".¹¹⁷¹

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

¹¹⁷⁰United States' appellee's submission, para. 112.

¹¹⁷¹Appellate Body Report, *US – Wool Shirts and Blouses*, p. 19, DSR 1997:1, 323 at 340.

"secure a positive solution" to this dispute.¹¹⁷² 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.

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 1994.¹¹⁷³

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

¹¹⁷²Our 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)

¹¹⁷³Brazil's further submission to the Panel, para. 277.

application in accordance with its own terms in respect of measures that fall within its respective scope of application".¹¹⁷⁴

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 in the section of the Panel Report dealing with "Export Subsidies".¹¹⁷⁵ 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*.¹¹⁷⁶

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 1994.¹¹⁷⁷

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*.¹¹⁷⁸ 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

¹¹⁷⁴Panel 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)

¹¹⁷⁵*Ibid.*, Section VII:E.

¹¹⁷⁶*Ibid.*, para. 7.1016.

¹¹⁷⁷*Ibid.*, para. 7.1017.

¹¹⁷⁸Brazil's other appellant's submission, para. 319.

is upon the effect of subsidies in enhancing exports, and not upon formal distinctions between export contingent and other subsidies.¹¹⁷⁹

754. Secondly, Brazil *conditionally* requests the Appellate Body to complete the analysis of its claim that United States price-contingent subsidies¹¹⁸⁰ 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.¹¹⁸¹ Brazil's request to complete the analysis is conditional upon two events: (i) a reversal by 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*).¹¹⁸² 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.¹¹⁸³

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.¹¹⁸⁴ 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.¹¹⁸⁵ 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.¹¹⁸⁶

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

¹¹⁷⁹Brazil's other appellant's submission, paras. 323-327.

¹¹⁸⁰That is, marketing loan payments, Step 2 payments, market loss assistance payments and counter-cyclical payments.

¹¹⁸¹Brazil's other appellant's submission, para. 318.

¹¹⁸²*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.

¹¹⁸³Brazil's other appellant's submission, paras. 371-379.

¹¹⁸⁴United States' appellee's submission, para. 167.

¹¹⁸⁵*Ibid.*, para. 168.

¹¹⁸⁶*Ibid.*, paras. 169-180.

on causation relative to trade shares. Nor has Brazil put forward a tenable standard for assessing what is more than an "equitable" trade share.¹¹⁸⁷

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 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*'.¹¹⁸⁸ 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 1994.¹¹⁸⁹

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*.

¹¹⁸⁷United States' appellee's submission, paras. 181-187.

¹¹⁸⁸Panel Report, para. 7.1016.

¹¹⁸⁹*Ibid.*, para. 7.1017

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*.¹¹⁹⁰ 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.

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.¹¹⁹¹ 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*";

¹¹⁹⁰*Supra*, para. 496.

¹¹⁹¹We 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)

- (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 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 Agreement¹¹⁹²;
 - (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

¹¹⁹²See Separate Opinion, *supra*, paras. 631-641.

- 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,
- (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:

Merit E. Janow
Presiding Member

Luiz Olavo Baptista
Member

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*.¹ 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 measures² are not exempt from actions under Article 13(b) of the *Agreement on Agriculture*.³ 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.

¹See, e.g., Panel Report, paras. 8.1(b), 7.337-7.414.

²See Panel Report, para. 7.337.

³See, 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*.⁴ 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*.⁵ 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").⁶ 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.⁷ 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

Agreement on Subsidies and Countervailing Measures.⁸ 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.⁹ 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."¹⁰

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.¹¹ This finding is in error and is based on erroneous findings on issues of law and related legal

⁴See, e.g., Panel Report, paras. 8.1(d)(1), 7.762-7.945.

⁵See, e.g., Panel Report, paras. 8.1(d)(2), 7.762-7.945.

⁶See, e.g., Panel Report, paras. 8.1(d)(1), 7.787-7.869, 7.946-7.948.

⁷See, e.g., Panel Report, paras. 7.678-7.761, 8.1(e).

⁸See, e.g., Panel Report, paras. 7.1018-7.1098, 8.1(f).

⁹Panel Report, paras. 7.1416, 7.1107-7.1416, 8.1(g)(i).

¹⁰See, e.g., Panel Report, para. 7.1501.

¹¹See, 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.¹² 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.¹³ 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,¹⁴ 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.¹⁵

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
Total	2012.7	3043.1	2092.4	3798.5	2471

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
Total	912.3	1149.1	1320.4	1027.5	1443.2

¹²See, e.g., Panel Report, para. 7.69.

¹³See, e.g., Panel Report, para. 7.103.

¹⁴See, e.g., Panel Report, para. 7.78.

¹⁵See, e.g., Panel Report, para. 7.104-7.122.

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
Total	2473.1	1519.6	3297	1940.5

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**

WT/DS308/AB/R
6 March 2006

(06-0914)

Original: English

**MEXICO – TAX MEASURES ON SOFT DRINKS
AND OTHER BEVERAGES**

AB-2005-10

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Annex I Notification of an Appeal by Mexico

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:I, 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:I, 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:I, 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:I, 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:I, 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:I, 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>
Working Procedures	<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").¹ 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").² 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"³ and that it "recommend to the

parties that they submit their respective grievances to an Arbitral Panel, under Chapter Twenty of the NAFTA⁴, 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.⁵ 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 1994.⁶

4. On 18 January 2005, the Panel issued a preliminary ruling in which it rejected Mexico's request.⁷ In doing so, the Panel concluded that, "under the DSU⁸", it had no discretion to decide whether or not to exercise its jurisdiction in a case properly before it.⁹ 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."¹⁰

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 HFCS¹¹ 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.

⁴North American Free Trade Agreement (the "NAFTA").

⁵Panel Report, para. 3.2.

⁶*Ibid.*

⁷The Panel's preliminary ruling is reproduced as Annex B to the Panel Report.

⁸*Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU").

⁹Panel Report, para. 7.1.

¹⁰*Ibid.*

¹¹High-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 1994.¹²

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."¹³ 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."¹⁴

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 Appeal¹⁵ pursuant to Rule 20(1) of the *Working Procedures for Appellate Review* (the "*Working Procedures*").¹⁶ On 13 December 2005, Mexico filed an appellant's submission.¹⁷ 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.¹⁸ On the same day, China, the European Communities, and Japan each filed a third participant's submission.¹⁹ 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.²⁰

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

¹²Panel Report, para. 9.2. (original underlining)

¹³Ibid., para. 9.3.

¹⁴Ibid., para. 9.5.

¹⁵WT/DS308/10 (attached as Annex I to this Report).

¹⁶WT/AB/WP/5, 4 January 2005.

¹⁷Pursuant 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.

¹⁸Pursuant to Rule 22(1) of the *Working Procedures*.

¹⁹Pursuant to Rule 24(1) of the *Working Procedures*.

²⁰Pursuant 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 Alcoholera* (National Chamber of the Sugar and Alcohol Industries) of Mexico.²¹ 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.²² Mexico submits that this is incorrect and ignores the fact that, like other international bodies and tribunals, WTO panels have certain "implied jurisdictional powers"²³ that derive from their nature as adjudicative bodies. According to Mexico, such powers include the power to refrain from exercising substantive

²¹At 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.

²²Mexico's appellant's submission, para. 64 ("obliga a un Grupo Especial de la OMC a abordar las reclamaciones").

²³Ibid., 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"²⁴ 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".²⁵ Mexico contends, in this regard, that the United States' claims under Article III of the GATT 1994 are inextricably linked to a broader dispute²⁶ 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"²⁷ 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.²⁸

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

²⁴Mexico's appellant's submission, para. 73 ("los elementos predominantes de una disputa derivan de reglas del derecho internacional").

²⁵Ibid. ("foro adecuado").

²⁶Ibid.

²⁷Ibid., para. 67 ("función jurisdiccional").

²⁸See *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".²⁹ 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)".³⁰ 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)".³¹ 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

²⁹Mexico's appellant's submission, para. 98 ("destino"; "resultado").

³⁰Ibid., 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)").

³¹Ibid., 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), (g), 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)*.³²

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

³²Mexico'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).³³ 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"³⁴, and, furthermore, the measures have been published.

20. Finally, Mexico argues that the Panel, "separately and in addition"³⁵ 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".³⁶ 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".³⁷

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

³³Mexico'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.")).

³⁴*Ibid.*, para. 182 ("una respuesta proporcional, legítima y legalmente justificada a las acciones y omisiones de Estados Unidos").

³⁵*Ibid.*, heading III.E ("independiente y adicional").

³⁶Panel Report, para. 8.186. See also, Mexico's Notice of Appeal, para. 3.

³⁷Mexico's appellant's submission, para. 166 ("la consecución de los objetivos de las contramedidas puede llevar tiempo").

recommendations³⁸ 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."³⁹

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."⁴⁰ 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."⁴¹ 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"⁴² 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.

³⁸United States' appellee's submission, para. 124.

³⁹*Ibid.*, para. 127 (quoting Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 36).

⁴⁰*Ibid.*, para. 129 (quoting Mexico's appellant's submission, para. 68).

⁴¹*Ibid.* (referring to Appellate Body Report, *US – Wool Shirts and Blouses*, p. 19, DSR 1997:I, 323, at 340; and to Appellate Body Report, *Canada – Wheat Exports and Grain Imports*, para. 133).

⁴²*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".⁴³ 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".⁴⁴ 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."⁴⁵ 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."⁴⁶ 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"⁴⁷ 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

⁴³The 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".

⁴⁴United States' appellee's submission, para. 37.

⁴⁵*Ibid.*, para. 85. (footnote omitted)

⁴⁶*Ibid.*, para. 41.

⁴⁷*Ibid.*, para. 54 (referring to Panel Report, paras. 8.175 and 8.178).

laws or regulations.⁴⁸ While the United States concedes that the Panel's analysis "could have admittedly been clearer"⁴⁹, 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."⁵⁰ 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."⁵¹ 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"⁵² 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".⁵³ 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."⁵⁴ 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.

⁴⁸United States' appellee's submission, para. 70 (quoting Mexico's appellant's submission, paras. 104-105).

⁴⁹*Ibid.*, para. 71.

⁵⁰*Ibid.* (original emphasis)

⁵¹*Ibid.*, para. 72. (footnote omitted)

⁵²*Ibid.*, para. 96.

⁵³*Ibid.*, para. 97.

⁵⁴*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.⁵⁵ 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".⁵⁶

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".⁵⁷

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".⁵⁸ China submits that, if a panel that is "empowered and obligated"⁵⁹ 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"⁶⁰ only if a panel has assumed the jurisdiction defined by its

⁵⁵According 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)

⁵⁶*Ibid.*, para. 114.

⁵⁷*Ibid.*, para. 118.

⁵⁸China's third participant's submission, para. 5.

⁵⁹*Ibid.*, para. 6.

⁶⁰*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 Panel's 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."⁶¹ 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."⁶²

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)".⁶³ 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.

⁶¹European Communities' third participant's submission, para. 8.

⁶²*Ibid.*, paras. 10-11.

⁶³*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"⁶⁴ 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"⁶⁵ 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 1994⁶⁶; 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."⁶⁷

⁶⁴Japan's third participant's submission, para. 22.

⁶⁵Panel Report, para. 7.18.

⁶⁶*Ibid.*, para. 8.198.

⁶⁷*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)."⁶⁸ 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."⁶⁹ 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."⁷⁰

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."⁷¹ 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."⁷² 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."⁷³ 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."⁷⁴ 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."⁷⁵ 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."⁷⁶

⁶⁸Panel Report, para. 7.1.

⁶⁹Ibid.

⁷⁰Ibid.

⁷¹Ibid., para. 7.7.

⁷²Ibid.

⁷³Ibid., para. 7.8 (referring to Appellate Body Report, *Australia – Salmon*, para. 223).

⁷⁴Ibid.

⁷⁵Ibid., para. 7.9.

⁷⁶Ibid.

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."⁷⁷ 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."⁷⁸ Mexico argues, in this regard, that the United States' claims under Article III of the GATT 1994 are inextricably linked to a broader dispute⁷⁹ 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"⁸⁰ 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."⁸¹

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'"⁸² 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.⁸³ 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."⁸⁴

⁷⁷Mexico'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").

⁷⁸Ibid., 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").

⁷⁹Ibid.

⁸⁰Ibid., para. 65 ("Nada en el ESD ... explicitamente descarta que ... existan").

⁸¹Ibid., para. 72 ("el Grupo Especial debió haber ejercido esa facultad en las circunstancias de esta disputa").

⁸²United States' appellee's submission, para. 125.

⁸³China's third participant's submission, para. 6.

⁸⁴European 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."⁸⁵ 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".⁸⁶ 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 them⁸⁷, and "should have exercised this power in the circumstances of this dispute".⁸⁸ 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"⁸⁹, 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

⁸⁵Mexico's appellant's submission, para. 71 ("Méjico no discute que el Grupo Especial tiene competencia para resolver la reclamación que Estados Unidos ha interpuesto") (quoting Mexico's response to Question 35 posed by the Panel; Panel Report, p. C-16). Mexico confirmed this point in response to questioning at the oral hearing.

⁸⁶Panel 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)

⁸⁷Thus, 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))

⁸⁸Mexico's appellant's submission, para. 72 ("debió haber ejercido esa facultad en las circunstancias de esta disputa").

⁸⁹Ibid., 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."⁹⁰ 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."⁹¹ 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".⁹² The Appellate Body has cautioned, nevertheless, that "[t]o provide only a partial resolution of the matter at issue would be false judicial economy."⁹³

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:

⁹⁰Appellate 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)

⁹¹Appellate Body Report, *EC – Hormones*, footnote 138 to para. 152. See also Appellate Body Report, *US – FSC (Article 21.5 – EC)*, paras. 247-248.

⁹²Appellate Body Report, *US – Wool Shirts and Blouses*, p. 19, DSR 1997:I, 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 validamente 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)

⁹³Appellate 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.*⁹⁴ (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"⁹⁵ 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 reference⁹⁶, 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.⁹⁷

⁹⁴Appellate Body Report, *India – Patents (US)*, para. 92.

⁹⁵Mexico's appellant's submission, para. 65 ("Nada en el ESD ... explicitamente descarta que ... existan").

⁹⁶The 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)

⁹⁷In 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".⁹⁸ 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.⁹⁹ 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'."¹⁰⁰ 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

⁹⁸Appellate Body Report, *Canada – Aircraft*, para. 187 (quoting *The Concise Oxford English Dictionary* (Clarendon Press, 1995), p. 1283).

⁹⁹See, 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.

¹⁰⁰Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review*, para. 89. (footnote omitted)

functioning of the WTO".¹⁰¹ 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.¹⁰² 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."¹⁰³

54. Mindful of the precise scope of Mexico's appeal¹⁰⁴, 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 dispute¹⁰⁵, and

¹⁰¹(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)

¹⁰²Article 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."

¹⁰³Panel Report, para. 7.8.

¹⁰⁴See *supra*, para. 44 and footnote 85 thereto.

¹⁰⁵Mexico's appellant's submission, para. 73.

that only a NAFTA panel could resolve the dispute as a whole.¹⁰⁶ 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."¹⁰⁷ 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.¹⁰⁸ 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 NAFTA¹⁰⁹ had not been "exercised".¹¹⁰ We do not express any view on whether a legal impediment to

¹⁰⁶In 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 oido*")") 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 protegió [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.

¹⁰⁷Panel 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.

¹⁰⁸Mexico's response to questioning at the oral hearing.

¹⁰⁹Article 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)

¹¹⁰Mexico's response to questioning at the oral hearing.

the exercise of a panel's jurisdiction would exist in the event that features such as those mentioned above were present.¹¹¹ 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"¹¹² 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.¹¹³ 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".¹¹⁴

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.¹¹⁵ 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.

¹¹¹In this context, Mexico has alluded to paragraph 7.38 of the Panel Report in *Argentina – Poultry Anti-Dumping Duties*. See also *supra*, footnote 86.

¹¹²Mexico's appellant's submission, para. 73 ("[es] cuestionable").

¹¹³See Panel Report, para. 7.14.

¹¹⁴Mexico's appellant's submission, para. 73 ("cuestiona que sus obligaciones sean aplicables frente a Estados Unidos a la 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)

¹¹⁵We 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.¹¹⁶

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 1994.¹¹⁷

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."¹¹⁸ The United States responded that "the NAFTA is not a 'law or regulation,' and Mexico's taxes are not 'necessary to secure compliance'."¹¹⁹

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".¹²⁰ 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".¹²¹ It further observed that Article XX(d) "is concerned with action at a domestic rather than international level."¹²² 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."¹²³

¹¹⁶Panel Report, paras. 7.1 and 7.18.

¹¹⁷Therefore, we express no view on the Panel's interpretation of Article III in this case.

¹¹⁸Panel Report, para. 8.162 (referring to Mexico's first written submission to the Panel, paras. 117-118 and 125).

¹¹⁹*Ibid.*, para. 8.163.

¹²⁰*Ibid.*, para. 8.175. (emphasis added)

¹²¹*Ibid.*, para. 8.178.

¹²²*Ibid.*, para. 8.179.

¹²³*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."¹²⁴ In contrast, "the outcome of international countermeasures, such as those adopted by Mexico, is inherently unpredictable".¹²⁵ Therefore, the Panel reasoned, international countermeasures are "not eligible to be considered as measures 'to secure compliance' within the meaning of Article XX(d)."¹²⁶ 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."¹²⁷ 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."¹²⁸

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).¹²⁹ 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."¹³⁰ 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."¹³¹

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

¹²⁴Panel Report, para. 8.185.

¹²⁵*Ibid.*, para. 8.186.

¹²⁶*Ibid.*

¹²⁷*Ibid.*

¹²⁸*Ibid.*, para. 8.190. (original emphasis)

¹²⁹*Ibid.*, para. 8.194.

¹³⁰*Ibid.*

¹³¹*Ibid.*, para. 8.197.

Article XX(d) of the GATT 1994.¹³² 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)¹³³, and whether the measures satisfy the requirements set out in the chapeau of Article XX.¹³⁴ Consequently, the Panel concluded that "Mexico has not established that the challenged measures are justified under Article XX of the GATT 1994."¹³⁵

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 countermeasures¹³⁶, and this error led the Panel to incorrectly interpret the terms "laws or regulations" in Article XX(d).¹³⁷ Mexico argues that the terms "laws or regulations" are "broad enough to include international agreements such as the NAFTA."¹³⁸ 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."¹³⁹

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."¹⁴⁰ 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.¹⁴¹ It would also undermine Article 22 of the DSU by "permit[ting] the suspension of concessions ... without DSB authorization and without any requirement to adhere to the rules established" in that provision.¹⁴²

¹³²Panel Report, para. 8.198.

¹³³*Ibid.*, para. 8.202.

¹³⁴*Ibid.*, para. 8.203.

¹³⁵*Ibid.*, para. 8.204.

¹³⁶Mexico's appellant's submission, para. 79 and footnote 49 thereto.

¹³⁷*Ibid.*, para. 126.

¹³⁸*Ibid.*, para. 129 ("suficientemente amplia para incluir tratados internacionales, como el TLCAN").

¹³⁹*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)

¹⁴⁰United States' appellee's submission, para. 30 (referring to definitions in *Black's Law Dictionary*, (1990), p. 816).

¹⁴¹*Ibid.*, para. 37.

¹⁴²*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".¹⁴³ 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."¹⁴⁴ 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."¹⁴⁵

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.

¹⁴³Appellate Body Report, *Korea – Various Measures on Beef*, para. 157.

¹⁴⁴*Ibid.*

¹⁴⁵*Ibid.* (referring to Appellate Body Report, *US – Gasoline*, pp. 22-23, DSR 1996:I, 3, at 20-21; Appellate Body Report, *US – Wool Shirts and Blouses*, pp. 14-16, DSR 1997:I, 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.¹⁴⁶ 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.¹⁴⁷ 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.¹⁴⁸ In our view, the terms "laws or regulations" refer to rules that form part of the domestic legal system of a WTO Member.¹⁴⁹ 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.¹⁵⁰ 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

¹⁴⁶United States' appellee's submission, footnote 62 to para. 39; Mexico's response to questioning at the oral hearing.

¹⁴⁷Panel Report, footnote 419 to para. 8.193; United States' appellee's submission, para. 31.

¹⁴⁸In 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.

¹⁴⁹The 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)

¹⁵⁰The 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.¹⁵¹ 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.¹⁵²

71. Our understanding of the terms "laws or regulations" is consistent with the context of Article XX(d). As the United States points out¹⁵³, 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".¹⁵⁴ The United States and China also draw our attention to Article X:1 of the GATT 1994¹⁵⁵, 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

regulations" in Article XX(d) as including the international obligations of a Member other than that invoking the provision.¹⁵⁶

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.¹⁵⁷ 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."¹⁵⁸ 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."¹⁵⁹ Thus, the Panel concluded that "the outcome of international countermeasures, such as those adopted by Mexico, is inherently unpredictable".¹⁶⁰

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.¹⁶¹ Mexico also asserts that the Panel, in its reasoning, incorrectly relied on the Appellate Body Report in *US – Gambling*.¹⁶² We agree with

¹⁵¹European Communities' third participant's submission, para. 38.

¹⁵²The 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.

¹⁵³United States' appellee's submission, para. 34.

¹⁵⁴If 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).

¹⁵⁵United States' appellee's submission, para. 35; China's third participant's submission, para. 21.

¹⁵⁶The 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)

¹⁵⁷Appellate Body Report, *Korea – Various Measures on Beef*, para. 157.

¹⁵⁸Panel Report, para. 8.175.

¹⁵⁹*Ibid.*, para. 8.185.

¹⁶⁰*Ibid.*, para. 8.186. See also Mexico's appellant's submission, paras. 104-116.

¹⁶¹The 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)

¹⁶²Panel 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"¹⁶³ 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".¹⁶⁴ 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.¹⁶⁵ Nor do we consider that the "use of coercion"¹⁶⁶ 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.

¹⁶³Appellate Body Report, *Korea – Various Measures on Beef*, para. 164.

¹⁶⁴We 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)

¹⁶⁵The 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)

¹⁶⁶Panel 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)*.¹⁶⁷ 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.¹⁶⁸ 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.¹⁶⁹ 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 out¹⁷⁰, 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.¹⁷¹ 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.

¹⁶⁷Mexico's appellant's submission, paras. 174-178.

¹⁶⁸See Appellate Body Report, *US – Shrimp*, paras. 2-6.

¹⁶⁹See *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.

¹⁷⁰United States' appellee's submission, para. 37.

¹⁷¹Mexico'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 argues¹⁷², 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.¹⁷³ As we noted earlier¹⁷⁴, this is not the function of panels and the Appellate Body as intended by the DSU.¹⁷⁵

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.¹⁷⁶ 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 1994.¹⁷⁷ 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).¹⁷⁸

¹⁷²At the oral hearing, Mexico argued that the terms "laws or regulations" would not include the WTO agreements because the latter are *lex specialis*.

¹⁷³Article 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)

¹⁷⁴See *supra*, para. 56.

¹⁷⁵We 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).

¹⁷⁶See *supra*, paras. 69-71.

¹⁷⁷See *supra*, para. 74.

¹⁷⁸See *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.¹⁷⁹ 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.¹⁸⁰

3. Mexico's Claim under Article 11 of the DSU¹⁸¹

82. Mexico argues, "separately and in addition"¹⁸² 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."¹⁸³ 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

¹⁷⁹Mexico's appellant's submission, para. 138.

¹⁸⁰See, for example, Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 74.

¹⁸¹In 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.

¹⁸²Mexico's appellant's submission, heading III.E ("*independiente y adicional*").

¹⁸³Panel Report, paragraph 8.186. See also, Mexico's Notice of Appeal, para. 3.

Mexico's grievances.¹⁸⁴ The United States submits that, contrary to Mexico's contention, the Panel did not "ignore" arguments or evidence submitted by Mexico.¹⁸⁵ 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'".¹⁸⁶

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

¹⁸⁴Mexico'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").

¹⁸⁵United States' appellee's submission, para. 118.

¹⁸⁶*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

**WORLD TRADE
ORGANIZATION**

ANNEX I

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, 8.215 to 8.230 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.¹
- (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 1994.²
- (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.³
- (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 1994.⁴

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".⁵ 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.⁶

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 1994⁷, 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.

¹ Panel Report, paragraphs 8.170 to 8.181.

² Panel Report, paragraphs 8.182 to 8.190 and 8.197 to 8.198.

³ Panel Report, paragraphs 8.191 to 8.197.

⁴ Panel Report, paragraphs 8.199 to 8.202.

⁵ Panel Report, paragraph 8.186.

⁶ Panel Report, paragraphs 8.231 and 8.232.

⁷ Panel Report, paragraphs 8.181 and 8.186.

**WORLD TRADE
ORGANIZATION**

WT/DS406/AB/R
4 April 2012

(12-1741)

Original: English

**UNITED STATES – MEASURES AFFECTING THE PRODUCTION
AND SALE OF CLOVE CIGARETTES**

AB-2012-1

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Annex I Notification of an Appeal by the United States, WT/DS406/

CASES CITED IN THIS REPORT

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>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/DS32/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
<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 – Alcoholic Beverages</i>	Appellate Body Report, <i>Chile – Taxes on Alcoholic Beverages</i> , WT/DS87/AB/R, WT/DS110/AB/R, adopted 12 January 2000, DSR 2000:I, 281
<i>Chile – Alcoholic Beverages</i>	Panel Report, <i>Chile – Taxes on Alcoholic Beverages</i> , WT/DS87/R, WT/DS110/R, adopted 12 January 2000, as modified by Appellate Body Report WT/DS87/AB/R, WT/DS110/AB/R, DSR 2000:I, 303
<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
<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
<i>EC – Approval and Marketing of Biotech Products</i>	Panel Report, <i>European Communities – Measures Affecting the Approval and Marketing of Biotech Products</i> , WT/DS291/R, WT/DS292/R, WT/DS293/R, Add.1 to Add.9, and Corr.1, adopted 21 November 2006, DSR 2006:III-VIII, 847
<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
<i>EC – Bananas III (Article 21.5 – Ecuador II) / EC – Bananas III (Article 21.5 – US)</i>	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
<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 – Fasteners (China)</i>	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
<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:I, 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 and certain member States – Large Civil Aircraft</i>	Appellate Body Report, <i>European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft</i> , WT/DS316/AB/R, adopted 1 June 2011
<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:I, 277
<i>Japan – Alcoholic Beverages II</i>	Panel Report, <i>Japan – Taxes on Alcoholic Beverages</i> , WT/DS8/R, WT/DS10/R, WT/DS11/R, adopted 1 November 1996, as modified by Appellate Body Report WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, DSR 1996:I, 125
<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:I, 97
<i>Japan – Apples</i>	Appellate Body Report, <i>Japan – Measures Affecting the Importation of Apples</i> , WT/DS245/AB/R, adopted 10 December 2003, DSR 2003:IX, 4391
<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:I, 5
<i>Mexico – Taxes on Soft Drinks</i>	Appellate Body Report, <i>Mexico – Tax Measures on Soft Drinks and Other Beverages</i> , WT/DS308/AB/R, adopted 24 March 2006, DSR 2006:I, 3
<i>Philippines – Distilled Spirits</i>	Appellate Body Reports, <i>Philippines – Taxes on Distilled Spirits</i> , WT/DS396/AB/R / WT/DS403/AB/R, adopted 20 January 2012
<i>Philippines – Distilled Spirits</i>	Panel Reports, <i>Philippines – Taxes on Distilled Spirits</i> , WT/DS396/R / WT/DS403/R, adopted 20 January 2012, as modified by Appellate Body Reports WT/DS396/AB/R / WT/DS403/AB/R
<i>Thailand – Cigarettes (Philippines)</i>	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
<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, DSR 2002:IX, 3779
<i>US – Clove Cigarettes</i>	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
<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 Appellate Body Report WT/DS2/AB/R, DSR 1996:I, 29
<i>US – Section 337 Tariff Act</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 – Stainless Steel (Mexico)</i>	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
<i>US – Steel Safeguards</i>	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
<i>US – Tuna (II) (Mexico)</i>	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
<i>US – Tuna II (Mexico)</i>	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]
<i>US – Upland Cotton (Article 21.5 – Brazil)</i>	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
<i>US – Wheat Gluten</i>	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
<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, 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/TobaccoProductsScientificAdvisoryCommittee/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 UNTS, 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

United States, *Appellant*
Indonesia, *Appellee*

Brazil, *Third Participant*
Colombia, *Third Participant*
Dominican Republic, *Third Participant*
European Union, *Third Participant*
Guatemala, *Third Participant*
Mexico, *Third Participant*
Norway, *Third Participant*
Turkey, *Third Participant*

AB-2012-1

Present:

Oshima, Presiding Member
Ramírez-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*¹ (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 Act² (the "FFDCA")—as amended by the Family Smoking Prevention and Tobacco Control Act³ (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 1994⁴, and could not be justified under Article XX(b) thereof.⁵

¹WT/DS406/R, 2 September 2011.

²Codified at *United States Code*, Title 21, Chapter 9, section 387g(a)(1)(A).

³United States Family Smoking Prevention and Tobacco Control Act, Public Law No. 111-31, 123 Stat. 1776 (22 June 2009) (Panel Exhibit US-7).

⁴Panel Report, para. 3.1.

⁵Panel 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.⁶ 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 1994.⁷

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.⁸ 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).⁹

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.¹⁰ 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".¹¹ 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.¹²

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

⁶Panel Report, paras. 7.293 and 8.1(b).

⁷Panel Report, paras. 7.294, 7.310, 8.3, and 8.4.

⁸Panel Report, paras. 7.550 and 8.1(f).

⁹Panel Report, paras. 7.595 and 8.1(h).

¹⁰Panel Report, paras. 7.432 and 8.1(c).

¹¹Panel Report, paras. 7.461, 7.463, and 8.1(d).

¹²Panel 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.¹³ 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.¹⁴ 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).¹⁵

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*.¹⁶

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 Appeal¹⁷ and an appellant's submission pursuant to Rules 20 and 21, respectively, of the *Working Procedures for Appellate Review*¹⁸ (the "*Working Procedures*"). On 23 January 2012, Indonesia filed an appellee's submission.¹⁹ On 26 January 2012, Brazil, Colombia, the European Union, Mexico, Norway, and Turkey each filed a third participant's submission.²⁰ On the same date, the Dominican Republic and Guatemala notified their intention to appear at the oral hearing as third participants.²¹

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

¹³Panel Report, paras. 7.549, 7.551, and 8.1(g).

¹⁴Panel Report, para. 7.507.

¹⁵Panel Report, paras. 7.649 and 8.1(i).

¹⁶Panel Report, para. 8.6.

¹⁷WT/DS406/6 (attached as Annex I to this Report).

¹⁸WT/AB/WP/6, 16 August 2010.

¹⁹Pursuant to Rule 22 of the *Working Procedures*.

²⁰Pursuant to Rule 24(1) of the *Working Procedures*.

²¹Pursuant 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 challenged²²—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.²³

(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".²⁴ 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 smoke²⁵—and erroneously based its ultimate conclusion on an "overly narrow analysis".²⁶

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."²⁷ 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

²²United States' appellant's submission, paras. 37 and 41.

²³United States' appellant's submission, para. 42.

²⁴United States' appellant's submission, para. 43 (quoting Panel Report, para. 7.199).

²⁵United States' appellant's submission, para. 44.

²⁶United States' appellant's submission, para. 45.

²⁷United 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.²⁸

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".²⁹ 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.³⁰ However, the United States contends that the Panel incorrectly considered end-uses "absent the relevant, real-world context"³¹ 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"³²—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.³³

(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.³⁴

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

²⁸United States' appellant's submission, para. 46.

²⁹United States' appellant's submission, para. 48.

³⁰United States' appellant's submission, para. 47 (quoting Appellate Body Report, *EC – Asbestos*, para. 102).

³¹United States' appellant's submission, para. 48.

³²United States' appellant's submission, para. 49.

³³United States' appellant's submission, para. 49.

³⁴United 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 FFDCA—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.³⁵ 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".³⁶ 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.³⁷

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".³⁸ 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.³⁹ 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.⁴⁰ 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.⁴¹

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.⁴² 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 issue⁴³, 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 objective

³⁵United States' appellant's submission, para. 58.

³⁶United 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)).

³⁷United States' appellant's submission, para. 53.

³⁸United States' appellant's submission, para. 54.

³⁹United States' appellant's submission, para. 58 (referring to Panel Report, paras. 2.24, 2.25, and 7.391).

⁴⁰United States' appellant's submission, para. 55.

⁴¹United States' appellant's submission, para. 58.

⁴²United States' appellant's submission, para. 59 (referring to Panel Report, paras. 7.116, 7.119, 7.201, and 7.206).

⁴³United States' appellant's submission, para. 59 (referring to Panel Report, paras. 7.245-7.249).

of the measure.⁴⁴ 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.⁴⁵ 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".⁴⁶ 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.⁴⁷

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 products⁴⁸, and thereby came to a "fatally flawed" conclusion on consumer tastes and habits.⁴⁹ 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.⁵⁰ 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*".⁵¹ 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".⁵² 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.⁵³ According

⁴⁴United States' appellant's submission, para. 60 (referring to Panel Report, para. 7.116).

⁴⁵United States' appellant's submission, para. 61.

⁴⁶United States' appellant's submission, para. 61. (original emphasis)

⁴⁷United States' appellant's submission, para. 63.

⁴⁸United States' appellant's submission, para. 64.

⁴⁹United States' appellant's submission, para. 68.

⁵⁰United 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)

⁵¹United States' appellant's submission, para. 67. (original emphasis)

⁵²United States' appellant's submission, para. 68 (quoting Panel Report, para. 7.214).

⁵³United 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.⁵⁴

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 FDCA 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.⁵⁵ 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".⁵⁶ Accordingly, the Panel was required to consider the "treatment of all domestic and imported cigarettes with characterizing flavors".⁵⁷ 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.⁵⁸ 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.⁵⁹

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

⁵⁴United States' appellant's submission, para. 69 (quoting Appellate Body Report, *EC – Hormones*, para. 133).

⁵⁵United States' appellant's submission, para. 74.

⁵⁶United 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.

⁵⁷United 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 flavours ... 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))

⁵⁸United States' appellant's submission, para. 79.

⁵⁹United States' appellant's submission, paras. 80 and 81. (original underlining)

accorded to the complaining Member's products are relevant.⁶⁰ 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".⁶¹ 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".⁶²

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 panel⁶³, the United States claims that the Panel erred in concluding that Indonesia, as the complaining party, "set the field of products to be compared"⁶⁴—that is, "imported clove cigarettes *versus* domestic menthol cigarettes".⁶⁵ 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.⁶⁶ 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."⁶⁷ The United States submits that such a statement reflects a "mis-application of the legal standard" under Article 2.1 of the *TBT Agreement*.⁶⁸ 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 favourable treatment analysis.⁶⁹ Therefore, the Panel should have taken into account the fact that

⁶⁰United States' appellant's submission, para. 84 (referring to Panel Report, para. 7.275).

⁶¹United States' appellant's submission, para. 84.

⁶²United States' appellant's submission, para. 85. (original underlining)

⁶³Request for the Establishment of a Panel by Indonesia, WT/DS406/2.

⁶⁴United States' appellant's submission, para. 87.

⁶⁵United States' appellant's submission, para. 86 (quoting Panel Report, para. 7.147 (original emphasis)).

⁶⁶United States' appellant's submission, para. 87.

⁶⁷United States' appellant's submission, para. 90 (quoting Panel Report, para. 7.289).

⁶⁸United States' appellant's submission, para. 91.

⁶⁹United States' appellant's submission, para. 91.

there were domestic cigarettes with characterizing flavours other than menthol in the years preceding the effective date of the ban.⁷⁰ 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".⁷¹ 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".⁷²

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 unrebutted 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 ban⁷³; (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.⁷⁴

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.⁷⁵

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

⁷⁰United 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 Flavored 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)).

⁷¹United States' appellant's submission, para. 93. (original emphasis)

⁷²United States' appellant's submission, para. 94.

⁷³United States' appellant's submission, para. 97 (referring to Panel Report, para. 2.27).

⁷⁴United 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)).

⁷⁵United States' appellant's submission, para. 99.

are explained by a factor or circumstance other than the origin of the products.⁷⁶ 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.⁷⁷ 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.⁷⁸

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"⁷⁹, the Panel failed to examine whether the detriment to the competitive situation of clove cigarettes was related to their origin.⁸⁰ 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".⁸¹ 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"⁸²—would remain unaltered regardless of where menthol cigarettes were produced, and even if all menthol cigarettes were imported.⁸³

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 basis⁸⁴, that Section 907(a)(1)(A) does not impose "any costs on any U.S. entity".⁸⁵ The United States recalls that Article 11 requires a panel to refrain from issuing "affirmative findings that lack a basis in the

⁷⁶United 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).

⁷⁷United 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).

⁷⁸United States' appellant's submission, paras. 103 and 104.

⁷⁹United States' appellant's submission, para. 105 (quoting Panel Report, para. 7.289).

⁸⁰United States' appellant's submission, para. 105.

⁸¹United States' appellant's submission, para. 106.

⁸²United States' appellant's submission, para. 107 (quoting Panel Report, para. 7.289).

⁸³United States' appellant's submission, para. 107.

⁸⁴United States' appellant's submission, para. 113.

⁸⁵United States' appellant's submission, para. 109. (original emphasis)

evidence contained in the panel record".⁸⁶ 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".⁸⁷ 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.⁸⁸ 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".⁸⁹

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 Concerns⁹⁰ (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.⁹¹

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 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*⁹² (the "Vienna Convention").⁹³ 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

⁸⁶United States' appellant's submission, para. 110 (quoting Appellate Body Report, *Canada – Wheat Exports and Grain Imports*, para. 181).

⁸⁷United States' appellant's submission, para. 110.

⁸⁸United States' appellant's submission, para. 110.

⁸⁹United States' appellant's submission, para. 111.

⁹⁰Decision of 14 November 2011, WT/MIN(01)/17.

⁹¹United States' appellant's submission, para. 123.

⁹²Done at Vienna, 23 May 1969, 1155 UNTS 331; 8 International Legal Materials 679.

⁹³United States' appellant's submission, para. 126.

"rule" that can be relied upon as the exclusive basis for concluding that the term "reasonable interval" means "not less than six months".⁹⁴

34. According to the United States, the Doha Ministerial Decision "preceded by several months"⁹⁵ 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.⁹⁶ 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).⁹⁷

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 paragraph⁹⁸, 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.⁹⁹ 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".¹⁰⁰

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".¹⁰¹ According to the United States, "Indonesia's assertion does not demonstrate what the Panel claimed Indonesia needed

⁹⁴United States' appellant's submission, para. 126 (quoting Panel Report, para. 7.559). (footnote omitted)

⁹⁵United States' appellant's submission, para. 125.

⁹⁶United States' appellant's submission, para. 131.

⁹⁷United States' appellant's submission, para. 133.

⁹⁸United States' appellant's submission, para. 135.

⁹⁹United States' appellant's submission, paras. 135 and 138.

¹⁰⁰United States' appellant's submission, para. 136.

¹⁰¹United 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).

to prove—that a six month interval period would be effective in fulfilling the legitimate objective of Section 907(a)(1)(A)¹⁰².

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"¹⁰³ 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".¹⁰⁴ 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"¹⁰⁵ 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.¹⁰⁶

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.¹⁰⁷ Indonesia also recalls that the United States did not appeal the Panel's conclusion that clove and menthol cigarettes share similar physical characteristics.¹⁰⁸

(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".¹⁰⁹ 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".¹¹⁰

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".¹¹¹ 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 FFDCA 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.¹¹² 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.¹¹³

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 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".¹¹⁴ Indeed, Indonesia

¹⁰²United States' appellant's submission, para. 149. (footnote omitted)

¹⁰³United States' appellant's submission, para. 132.

¹⁰⁴United States' appellant's submission, para. 152. (original emphasis)

¹⁰⁵United States' appellant's submission, para. 152 (quoting Panel Report, para. 7.583).

¹⁰⁶United States' appellant's submission, para. 153 (quoting Panel Report, para. 7.594).

¹⁰⁷Indonesia's appellee's submission, para. 65.

¹⁰⁸Indonesia's appellee's submission, para. 66.

¹⁰⁹Indonesia's appellee's submission, para. 67.

¹¹⁰Indonesia's appellee's submission, para. 68 (quoting Appellate Body Reports, *Philippines – Distilled Spirits*, para. 71).

¹¹¹Indonesia'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)

¹¹²Indonesia's appellee's submission, para. 73.

¹¹³Indonesia's appellee's submission, para. 74 (referring to Panel Report, para. 7.198).

¹¹⁴Indonesia's appellee's submission, para. 75.

argues, the Panel simply was not persuaded by the merits of the argument of the United States¹¹⁵ and proceeded to conclude—based on evidence showing that both clove and menthol cigarettes were capable of delivering nicotine¹¹⁶—that the end-use of both types of cigarettes was "to be smoked".¹¹⁷ Although the United States asserted that there was an "occasional"-use cigarette market, it provided little evidence in support of this claim.¹¹⁸ 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".¹¹⁹

(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.¹²⁰ 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".¹²¹ 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".¹²²

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

¹¹⁵Indonesia's appellee's submission, para. 77.

¹¹⁶Indonesia's appellee's submission, para. 78 (referring to Panel Report, para. 7.196).

¹¹⁷Indonesia's appellee's submission, para. 76 (referring to Panel Report, para. 7.199).

¹¹⁸Indonesia's appellee's submission, para. 78 (referring to United States' response to Panel Question 41, paras. 104-106).

¹¹⁹Indonesia's appellee's submission, para. 79.

¹²⁰Indonesia's appellee's submission, para. 80.

¹²¹Indonesia's appellee's submission, para. 81 (quoting Appellate Body Report, *EC – Asbestos*, para. 101). (emphasis added by Indonesia omitted)

¹²²Indonesia's appellee's submission, para. 82 (referring to Appellate Body Reports, *Philippines – Distilled Spirits*, para. 149). (original emphasis)

compare "in light of the context and the object and purpose of the provision at issue" and of the measure.¹²³ 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".¹²⁴ 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".¹²⁵

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 analysis¹²⁶, but to lay out very carefully the basis for its decision to focus on current and pre-smoking youth.¹²⁷ 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.¹²⁸ 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".¹²⁹

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 smokers.¹³⁰ On the contrary, Indonesia posits, the Panel specifically identified the consumers at issue

¹²³Indonesia's appellee's submission, para. 83 (quoting Appellate Body Report, *EC – Asbestos*, paras. 88 and 89). (emphasis added by Indonesia omitted)

¹²⁴Indonesia's appellee's submission, para. 84 (referring to United States' appellant's submission, para. 60).

¹²⁵Indonesia's appellee's submission, para. 86 (quoting Panel Report, para. 7.119).

¹²⁶Indonesia's appellee's submission, para. 87 (referring to United States' appellant's submission, para. 54).

¹²⁷Indonesia's appellee's submission, para. 88 (referring to Panel Report, para. 7.119).

¹²⁸Indonesia's appellee's submission, paras. 90 and 91.

¹²⁹Indonesia's appellee's submission, para. 92 (quoting Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 21, DSR 1996:I, 97, at 114).

¹³⁰Indonesia's appellee's submission, para. 100 (referring to United States' appellant's submission, para. 64).

in this case as "*young smokers and potential young smokers*".¹³¹ In addressing the United States' specific claims, Indonesia argues that the Panel did not wilfully 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.¹³² 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.¹³³

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.¹³⁴ 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.¹³⁵

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"¹³⁶ 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.¹³⁷ In conclusion, Indonesia requests the Appellate Body to reject the United States' claims with respect to the Panel's findings on consumer tastes and

¹³¹Indonesia's appellee's submission, para. 100 (quoting Panel Report, para. 7.232). (emphasis added by Indonesia)

¹³²Indonesia's appellee's submission, para. 104 (referring to Panel Report, paras. 7.209 and 7.210 and footnotes 426-430 thereto).

¹³³Indonesia's appellee's submission, para. 106.

¹³⁴Indonesia's appellee's submission, para. 111.

¹³⁵Indonesia's appellee's submission, paras. 112-114.

¹³⁶Indonesia's appellee's submission, para. 116.

¹³⁷Indonesia'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).

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*.¹³⁸

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.¹³⁹ While the panels in both of the above disputes had conducted an initial like product analysis of a group of products¹⁴⁰, 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".¹⁴¹ 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.¹⁴² 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.¹⁴³

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

¹³⁸Indonesia's appellee's submission, para. 118.

¹³⁹Indonesia's appellee's submission, para. 121 (referring to United States' appellant's submission, para. 77).

¹⁴⁰Indonesia's appellee's submission, para. 126.

¹⁴¹Indonesia's appellee's submission, para. 130.

¹⁴²Indonesia's appellee's submission, para. 139 (referring to Panel Report, para. 7.277).

¹⁴³Indonesia's appellee's submission, paras. 140 and 141; see also para. 142 (quoting Appellate Body Report, *Chile – Price Band System*, para. 173).

argument as speculative and emphasizes that the Panel referred to its terms of reference in the context of its like products analysis.¹⁴⁴ 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.¹⁴⁵ 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".¹⁴⁶ 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.¹⁴⁷

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"¹⁴⁸, 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"¹⁴⁹ on the timeframe for analyzing less favourable treatment, neither is there a mandate to consider any specific timeframe for this analysis.¹⁵⁰ 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".¹⁵¹

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 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

¹⁴⁴Indonesia'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).

¹⁴⁵Indonesia'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).

¹⁴⁶Indonesia's appellee's submission, para. 150.

¹⁴⁷Indonesia's appellee's submission, para. 150.

¹⁴⁸Indonesia's appellee's submission, para. 151.

¹⁴⁹Indonesia's appellee's submission, para. 152 (quoting United States' appellant's submission, para. 89).

¹⁵⁰Indonesia's appellee's submission, para. 152; see also para. 154 (quoting Panel Report, *US – Tuna II (Mexico)*, paras. 7.299 and 7.300).

¹⁵¹Indonesia's appellee's submission, para. 157.

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.¹⁵² 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".¹⁵³ 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 dispute¹⁵⁴ 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.¹⁵⁵ 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 "misreading" of the Appellate Body report in *Dominican Republic – Import and Sale of Cigarettes*.¹⁵⁶ 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.¹⁵⁷ 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'".¹⁵⁸ In other words, Indonesia contends that the Panel's conclusion that imported clove cigarettes are treated less favourably than domestic menthol cigarettes—because the former are banned from the US market, whereas the latter

¹⁵²Indonesia's appellee's submission, paras. 158 and 162 (referring to Panel Report, footnote 524 to para. 7.289).

¹⁵³Indonesia'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)).

¹⁵⁴Indonesia'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).

¹⁵⁵Indonesia'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).

¹⁵⁶Indonesia's appellee's submission, para. 173 (referring to Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 96).

¹⁵⁷Indonesia'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).

¹⁵⁸Indonesia'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).

are not—is *per se* sufficient to make a finding that the United States acted inconsistently with Article 2.1 of the *TBT Agreement*.¹⁵⁹

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 jobs¹⁶⁰; 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.¹⁶¹ 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.¹⁶²

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".¹⁶³ 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.

¹⁵⁹Indonesia's appellee's submission, para. 172.

¹⁶⁰Indonesia'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)).

¹⁶¹Indonesia'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).

¹⁶²Indonesia's appellee's submission, para. 195.

¹⁶³Indonesia'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"¹⁶⁴ 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*.¹⁶⁵ 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".¹⁶⁶

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.¹⁶⁷ 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.¹⁶⁸ 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".¹⁶⁹

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 2.12.¹⁷⁰ 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.¹⁷¹ 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

¹⁶⁴Indonesia's appellee's submission, para. 205 (quoting United States' appellant's submission, para. 126).

¹⁶⁵Indonesia's appellee's submission, para. 206.

¹⁶⁶Indonesia's appellee's submission, paras. 220 and 221.

¹⁶⁷Indonesia's appellee's submission, para. 223 (referring to United States' appellant's submission, para. 128).

¹⁶⁸Indonesia's appellee's submission, para. 227.

¹⁶⁹Indonesia's appellee's submission, para. 230 (quoting Panel Report, para. 7.594).

¹⁷⁰Indonesia's appellee's submission, para. 233.

¹⁷¹Indonesia's appellee's submission, para. 237.

that its claim against the United States under Article 2.12 was true.¹⁷² 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".¹⁷³ 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.¹⁷⁴ 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*.¹⁷⁵

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.¹⁷⁶ 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".¹⁷⁷

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

¹⁷²Indonesia's appellee's submission, para. 234.

¹⁷³Indonesia's appellee's submission, para. 240 (quoting Appellate Body Report, *US – Wool Shirts and Blouses*, pp. 16-17, DSR 1997:I, 323, at 338).

¹⁷⁴Indonesia's appellee's submission, para. 240 (referring to Panel Report, para. 7.593).

¹⁷⁵Indonesia's appellee's submission, para. 241 (referring to Panel Report, para. 7.593).

¹⁷⁶Indonesia's appellee's submission, para. 242. (underlining omitted)

¹⁷⁷Indonesia'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.¹⁷⁸ 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.¹⁷⁹ 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.¹⁸⁰ 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 possible¹⁸¹, looking at the measure's structure, architecture, and design.¹⁸² 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.¹⁸³ 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.¹⁸⁴ 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.¹⁸⁵ 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

¹⁷⁸Brazil's third participant's submission, para. 8.

¹⁷⁹Brazil'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).

¹⁸⁰Brazil's third participant's submission, para. 14.

¹⁸¹Brazil's third participant's submission, para. 17.

¹⁸²Brazil's third participant's submission, para. 20 (referring to Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 29, DSR 1996:I, 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).

¹⁸³Brazil's third participant's submission, para. 23 (referring to United States' appellant's submission, paras. 101-106).

¹⁸⁴Brazil's third participant's submission, para. 28 (referring to Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 28, DSR 1996:I, 97, at 119).

¹⁸⁵Brazil'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.¹⁸⁶

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.¹⁸⁷ 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.¹⁸⁸ 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 overlooked¹⁸⁹; 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.¹⁹⁰ 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*.¹⁹¹

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 the import and domestic sides" (the "horizontal line")¹⁹², 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").¹⁹³ 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

¹⁸⁶Brazil's third participant's submission, para. 30.

¹⁸⁷Colombia's third participant's submission, para. 6 (quoting Panel Report, para. 7.576).

¹⁸⁸Colombia's third participant's submission, para. 10.

¹⁸⁹Colombia's third participant's submission, para. 14.

¹⁹⁰Colombia's third participant's submission, para. 15.

¹⁹¹Colombia's third participant's submission, para. 19.

¹⁹²European Union's third participant's submission, para. 17. (original underlining)

¹⁹³European Union's third participant's submission, para. 18. (original underlining)

one cannot meaningfully test for *de facto* discrimination.¹⁹⁴ 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.¹⁹⁵ 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.¹⁹⁶ 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.¹⁹⁷

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.¹⁹⁸ In its view, the problem is to distinguish between the exercise of regulatory autonomy that is acceptable, and that which is not.¹⁹⁹ 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.²⁰⁰ 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*.²⁰¹ 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.²⁰² 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.²⁰³ 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.²⁰⁴ If Indonesia

¹⁹⁴European Union's third participant's submission, para. 19.

¹⁹⁵European Union's third participant's submission, para. 20.

¹⁹⁶European Union's third participant's submission, para. 21.

¹⁹⁷European Union's third participant's submission, para. 23.

¹⁹⁸European Union's third participant's submission, para. 32.

¹⁹⁹European Union's third participant's submission, para. 33.

²⁰⁰European Union's third participant's submission, para. 44.

²⁰¹European Union's third participant's submission, para. 51.

²⁰²European Union's third participant's submission, para. 54.

²⁰³European Union's third participant's submission, para. 54 (referring to United States' appellant's submission, paras. 32-36, 54, 55, and 61-63).

²⁰⁴European 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*.²⁰⁵

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.²⁰⁶ 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.²⁰⁷ 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.²⁰⁸ 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*.²⁰⁹

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".²¹⁰ 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".²¹¹ 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*.²¹² Mexico further stresses that, if regulatory distinctions could be used to determine like products, this could "render the concept of *de facto* discrimination meaningless".²¹³

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

²⁰⁵European Union's third participant's submission, para. 57.

²⁰⁶European Union's third participant's submission, para. 62.

²⁰⁷European Union's third participant's submission, para. 63.

²⁰⁸European Union's third participant's submission, para. 66.

²⁰⁹European Union's third participant's submission, para. 67 (referring to Appellate Body Report, *EC – Sardines*, paras. 259-282).

²¹⁰Mexico's third participant's submission, para. 15.

²¹¹Mexico's third participant's submission, para. 16.

²¹²Mexico's third participant's submission, paras. 17-19.

²¹³Mexico'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".²¹⁴ 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".²¹⁵ 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.²¹⁶

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.²¹⁷ Second, with respect to the United States' argument that there is no temporal limitation on the analysis of *de facto* less favourable treatment²¹⁸, Mexico posits that the date of a panel's establishment is "the key date" when assessing whether *de facto* discrimination exists.²¹⁹ 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".²²⁰ 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".²²¹ 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.

²¹⁴Mexico's third participant's submission, para. 40. (original emphasis)

²¹⁵Mexico's third participant's submission, para. 43.

²¹⁶Mexico's third participant's submission, para. 48 (referring to Panel Report, paras. 7.276-7.279).

²¹⁷Mexico's third participant's submission, paras. 53 and 54.

²¹⁸Mexico's third participant's submission, para. 56 (referring to United States' appellant's submission, paras. 91-94).

²¹⁹Mexico's third participant's submission, para. 57.

²²⁰Mexico's third participant's submission, para. 59.

²²¹Mexico'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.²²² 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".²²³ 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".²²⁴

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)".²²⁵ 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".²²⁶ According to Norway, the correct starting point for the analysis should be "the entire group of products identified as like products".²²⁷ 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.²²⁸ 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"²²⁹, 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.²³⁰

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 1994.²³¹ 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".²³² 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.²³³ 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".²³⁴ 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.²³⁵

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.²³⁶ 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".²³⁷ 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".²³⁸

²²²Norway's third participant's submission, para. 5.

²²³Norway's third participant's submission, para. 6 (quoting Panel Report, para. 7.139).

²²⁴Norway's third participant's submission, para. 7.

²²⁵Norway's third participant's submission, para. 12 (referring to Panel Report, paras. 7.274 and 7.275). (original emphasis)

²²⁶Norway's third participant's submission, para. 12. (original emphasis)

²²⁷Norway'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)

²²⁸Norway's third participant's submission, para. 15. (original emphasis)

²²⁹Norway's third participant's submission, para. 20 (referring to Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 96).

²³⁰Norway's third participant's submission, para. 21.

²³¹Turkey's third participant's submission, para. 4 (referring to Panel Report, para. 7.117).

²³²Turkey's third participant's submission, para. 5 (quoting Panel Report, para. 7.116).

²³³Turkey's third participant's submission, para. 7 (quoting Appellate Body Report, *EC – Asbestos*, para. 101).

²³⁴Turkey's third participant's submission, para. 11.

²³⁵Turkey's third participant's submission, para. 15.

²³⁶Turkey's third participant's submission, paras. 18 and 19.

²³⁷Turkey's third participant's submission, para. 21.

²³⁸Turkey'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 Act²³⁹ (the "FFDCA"). Section 907(a)(1)(A) was added to the FFDCA by Section 101(b) of the Family Smoking Prevention and Tobacco Control Act²⁴⁰ (the "FSPTCA")²⁴¹, and became law on 22 June 2009.²⁴²

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 Committee²⁴³ (the "House Report")

²³⁹Supra, footnote 2.

²⁴⁰Supra, footnote 3.

²⁴¹Panel Report, para. 2.4.

²⁴²Panel Report, para. 2.5 (referring to Indonesia's first written submission to the Panel, footnote 1 to para. 1).

²⁴³H.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."²⁴⁴ 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.²⁴⁵

80. According to the Guidance for Industry and FDA Staff²⁴⁶ ("FDA Guidance"), Section 907(a)(1)(A) applies to all flavoured tobacco products²⁴⁷ that meet the definition of a "cigarette" in Section 3(1) of the Federal Cigarette Labeling and Advertising Act²⁴⁸, 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)."²⁴⁹ 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.²⁵⁰

81. The Panel identified the products at issue in this dispute as being clove cigarettes and menthol cigarettes.²⁵¹ Clove cigarettes are composed of tobacco combined with flavouring additives, which is presented to the consumer in a paper wrapped with a filter.²⁵² More specifically, clove cigarettes are generally manufactured with 60 to 80 per cent tobacco content, usually resulting from a blend of

²⁴⁴House Report, p. 14.

²⁴⁵House Report, p. 37.

²⁴⁶"General Questions and Answers on the Ban of Cigarettes that Contain Characterizing Flavors (Edition 2)", 23 December 2009 (Panel Exhibit IND-41).

²⁴⁷The 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)

²⁴⁸United States Code, Title 15, Chapter 36.

²⁴⁹FDA Guidance, answer to Question 2.

²⁵⁰FDA Guidance, answers to Questions 3 and 4.

²⁵¹Panel Report, para. 7.147.

²⁵²Panel 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.²⁵³ 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.²⁵⁴ They also generally include a "sauce" as part of the flavouring ingredients chosen by each manufacturer²⁵⁵, as well as other components inherent to cloves, such as benzyl acetate, methyl salicylate, trans-anethole, and methyl eugenol.²⁵⁶ Before the Panel, the parties did not dispute that clove cigarettes contain eugenol²⁵⁷—a substance that the United States defined as "a common topical anesthetic used in dental procedures"²⁵⁸—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.²⁵⁹

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.²⁶⁰ The Panel noted that the March 2011 report by the Tobacco Products Scientific Advisory Committee to the FDA²⁶¹ (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."²⁶² 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 ways²⁶³ and diffuses throughout the cigarette, irrespective of the means of application.²⁶⁴ 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

²⁵³Panel 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* (Panel Exhibit IND-29); United States' first written submission to the Panel, para. 163; and Indonesia's and United States' responses to Panel Question 33).

²⁵⁴Panel Report, para. 7.159.

²⁵⁵Panel Report, para. 7.160 (referring to United States' first written submission to the Panel, para. 165).

²⁵⁶Panel Report, para. 7.164 (referring to Indonesia's response to Panel Question 30).

²⁵⁷Panel Report, para. 7.162.

²⁵⁸Panel Report, para. 7.161 (quoting United States' first written submission to the Panel, para. 38).

²⁵⁹Panel 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).

²⁶⁰Panel 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)

²⁶¹Available at <http://www.fda.gov/downloads/AdvisoryCommittees/CommitteesMeetingMaterials/TobaccoProductsScientificAdvisoryCommittee/UCM247689.pdf>.

²⁶²Panel Report, para. 7.166.

²⁶³The 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)

²⁶⁴Panel Report, para. 7.167.

to roughly 1 per cent of the content of the cigarette, although the specific amount varies from brand to brand.²⁶⁵ Moreover, menthol may have cooling, analgesic, or irritating properties, and is reported to reduce sensitivity to noxious chemicals, including nicotine.²⁶⁶

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.²⁶⁷ 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*"²⁶⁸, 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*".²⁶⁹

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

²⁶⁵According 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))

²⁶⁶Panel Report, para. 7.168 (referring to March 2011 TPSAC Report, pp. 18-20 and 22).

²⁶⁷Panel Report, paras. 7.293, 8.1(a), and 8.1(b).

²⁶⁸Panel Report, para. 7.248.

²⁶⁹Panel 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.²⁷⁰

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;

²⁷⁰We 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 1994²⁷¹, 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

²⁷¹Panel 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".²⁷² 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:

²⁷²The 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*.²⁷³ 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 1994.²⁷⁴

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

²⁷³We 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. (Appellate Body Report, *EC – Asbestos*, paras. 88-89)

²⁷⁴In 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*.²⁷⁵ 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".²⁷⁶ 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 1994.²⁷⁷ 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.²⁷⁸ 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*.²⁷⁹

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

²⁷⁵Panel Report, para. 7.248.

²⁷⁶Panel Report, para. 7.244.

²⁷⁷Panel Report, para. 7.99.

²⁷⁸Panel Report, para. 7.106.

²⁷⁹Panel Report, para. 7.105.

"some weight and potentially considerable weight" in the determination of whether the products at issue are like.²⁸⁰ 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 1994.²⁸¹

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.²⁸² 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.²⁸³

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

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*.²⁸⁴ 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'".²⁸⁵ 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"²⁸⁶ 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".²⁸⁷

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

²⁸⁰Panel Report, para. 7.109.

²⁸¹Panel Report, para. 7.114.

²⁸²Panel Report, para. 7.119.

²⁸³Panel Report, para. 7.119.

²⁸⁴Panel Report, para. 7.99.

²⁸⁵Appellate Body Report, *EC – Asbestos*, para. 98. (original emphasis)

²⁸⁶Appellate Body Report, *EC – Asbestos*, para. 99.

²⁸⁷Appellate 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.²⁸⁸

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.²⁸⁹ The United States questions the basis for the Panel's narrow focus on the immediate objective of the measure²⁹⁰ and cites to other regulatory objectives related to health considerations associated with heavily used cigarettes to draw further distinctions between menthol and clove cigarettes.²⁹¹

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

²⁸⁸See Panel Report, *Japan – Alcoholic Beverages II*, para. 6.16.

²⁸⁹Panel Report, para. 7.119.

²⁹⁰United States' appellant's submission, para. 60.

²⁹¹The 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.²⁹² 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.²⁹³ 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.²⁹⁴

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.

²⁹²Appellate Body Report, *EC – Asbestos*, para. 113.

²⁹³The 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)

²⁹⁴The 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"²⁹⁵, 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.²⁹⁶ 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.²⁹⁷

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.²⁹⁸ 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.²⁹⁹

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.³⁰⁰

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

²⁹⁵Panel Report, para. 7.199.

²⁹⁶Panel Report, para. 7.198.

²⁹⁷Panel Report, para. 7.197.

²⁹⁸United States' appellant's submission, para. 45.

²⁹⁹United States' appellant's submission, para. 46.

³⁰⁰Indonesia's appellee's submission, para. 73.

use the products to perform these functions".³⁰¹ 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"³⁰² and "not mutually exclusive", so that certain evidence may well fall under more than one criterion.³⁰³ 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.³⁰⁴

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*.

³⁰¹Appellate Body Report, *EC – Asbestos*, para. 117. (emphasis added)

³⁰²Appellate Body Report, *EC – Asbestos*, para. 102.

³⁰³Appellate 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)

³⁰⁴Appellate 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.³⁰⁵

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".³⁰⁶

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".³⁰⁷ 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.³⁰⁸ 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.

³⁰⁵Similarly, 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))

³⁰⁶Indonesia's appellee's submission, para. 73.

³⁰⁷Panel Report, para. 7.231.

³⁰⁸In 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.³⁰⁹ 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).³¹⁰ 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.³¹¹ 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".³¹²

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.³¹³ 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.³¹⁴

³⁰⁹Panel Report, para. 7.206.

³¹⁰Panel Report, para. 7.214.

³¹¹Panel Report, para. 7.217.

³¹²Panel Report, para. 7.232.

³¹³United States' appellant's submission, para. 54.

³¹⁴United 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.³¹⁵

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.³¹⁶ 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.³¹⁷

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.

³¹⁵United 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)

³¹⁶Section V.B.1 of this Report.

³¹⁷See *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.³¹⁸

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.³¹⁹

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".³²⁰

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

³¹⁸Panel Report, paras. 7.206.

³¹⁹United States' appellant's submission, para. 55.

³²⁰Indonesia'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 [p]anel 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".³²¹ 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".³²²

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.³²³ 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.³²⁴ 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.

³²¹Appellate Body Reports, *Philippines – Distilled Spirits*, para. 220.

³²²Appellate Body Reports, *Philippines – Distilled Spirits*, para. 221 (referring to Panel Report, *Chile – Alcoholic Beverages*, para. 7.43). (original emphasis)

³²³In *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)

³²⁴Panel 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.³²⁵

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".³²⁶ 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*".³²⁷, 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.³²⁸

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*".³²⁹ Instead, the Panel "clearly articulated the difficulties it encountered in comparing the survey data"³³⁰ 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

³²⁵United States' appellant's submission, para. 64.

³²⁶United States' appellant's submission, para. 66 (quoting Panel Report, para. 7.210).

³²⁷United States' appellant's submission, para. 67. (original emphasis)

³²⁸United States' appellant's submission, para. 68.

³²⁹Indonesia's appellee's submission, para. 106.

³³⁰Indonesia's appellee's submission, para. 115.

are "trainer" or "starter" cigarettes that appeal to youth.³³¹ Based on this evidence on record, the Panel properly found that "all these flavoured cigarettes are perceived as vehicles to start smoking".³³²

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."³³³ In addition, panels "are not required to accord to factual evidence of the parties the same meaning and weight as do the parties."³³⁴ 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".³³⁵ 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"³³⁶, must base its finding on a sufficient evidentiary basis³³⁷, and must treat evidence with "even-handedness".³³⁸ 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.³³⁹

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.³⁴⁰ The Panel observed,

³³¹Indonesia's appellee's submission, para. 111.

³³²Indonesia's appellee's submission, para. 113 (quoting Panel Report, para. 7.231).

³³³Appellate 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).

³³⁴Appellate Body Report, *Australia – Salmon*, para. 267.

³³⁵Appellate Body Reports, *Philippines – Distilled Spirits*, para. 136 (quoting Appellate Body Report, *US – Wheat Gluten*, para. 151).

³³⁶Appellate Body Report, *US – Upland Cotton (Article 21.5 – Brazil)*, footnote 618 to para. 293.

³³⁷See Appellate Body Report, *US – Carbon Steel*, para. 148.

³³⁸Appellate Body Report, *US – Upland Cotton (Article 21.5 – Brazil)*, para. 292.

³³⁹See Appellate Body Report, *EC – Fasteners (China)*, para. 442.

³⁴⁰Indonesia 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"³⁴¹; instead, they "examine[d] different age groups", "pose[d] different questions", and were "based on different methodological approaches".³⁴² 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"³⁴³, 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.³⁴⁴

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"³⁴⁵, 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"³⁴⁶ 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.³⁴⁷ 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".³⁴⁸ In the United States' view, the survey data presented by the parties "show that consumers and potential consumers use and perceive

clove and menthol cigarettes differently—even though they are both cigarettes with characterizing flavors that appeal to youth".³⁴⁹

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

³⁴¹Panel Report, para. 7.210.

³⁴²Panel Report, para. 7.210.

³⁴³Panel Report, para. 7.210.

³⁴⁴Panel Report, para. 7.209.

³⁴⁵Appellate 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).

³⁴⁶Appellate Body Report, *US – Upland Cotton (Article 21.5 – Brazil)*, footnote 618 to para. 293.

³⁴⁷Appellate Body Report, *EC – Fasteners (China)*, para. 442.

³⁴⁸United States' appellant's submission, para. 68.

³⁴⁹United States' appellant's submission, para. 69.

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".³⁵⁰ 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";³⁵¹ and that they are both classified under subheading 2402.20 of the Harmonized Commodity Description and Coding System.³⁵²

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

³⁵⁰Panel Report, para. 7.231; United States' response to Panel Question 37, para. 85.

³⁵¹Panel Report, para. 7.187.

³⁵²Panel Report, para. 7.239.

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.³⁵³ 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.³⁵⁴ 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.³⁵⁵ 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.³⁵⁶ 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",³⁵⁷ 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.³⁵⁸

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

³⁵³Panel Report, para. 7.270.

³⁵⁴Panel Report, paras. 7.275-7.277.

³⁵⁵Panel Report, paras. 7.279 and 7.280.

³⁵⁶Panel Report, para. 7.281.

³⁵⁷Panel 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).

³⁵⁸Panel 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 1994³⁵⁹, 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 2.1.³⁶⁰ 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

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".³⁶¹

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.

³⁵⁹See Appellate Body Report, *Korea – Various Measures on Beef*, para. 137.

³⁶⁰Indonesia's appellee's submission, para. 172.

³⁶¹United 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).

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 earlier³⁶², 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

³⁶²Supra, 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 1994.³⁶³ 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".³⁶⁴ Subsequent GATT and WTO panels followed a similar approach, and found violations of Article III:4 in cases where regulatory distinctions in enforcement procedures³⁶⁵, distribution channels³⁶⁶, statutory content requirements³⁶⁷, and allocation of import licenses³⁶⁸ 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.³⁶⁹ 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.³⁷⁰ (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

³⁶³Article 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.

³⁶⁴GATT Panel Report, *US – Section 337 Tariff Act*, para. 5.10.

³⁶⁵GATT Panel Report, *US – Section 337 Tariff Act*, para. 5.20.

³⁶⁶GATT Panel Report, *Canada – Provincial Liquor Boards (US)*, paras. 5.12-5.16.

³⁶⁷Panel Report, *US – Gasoline*, para. 6.10.

³⁶⁸Panel Reports, *EC – Bananas III*, paras. 7.179-7.180.

³⁶⁹Appellate Body Report, *Korea – Various Measures on Beef*, para. 136.

³⁷⁰Appellate 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.³⁷¹ (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.³⁷²

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

³⁷¹Appellate Body Report, *EC – Asbestos*, para. 100.

³⁷²We 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 reasons³⁷³, 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)).³⁷⁴ The United States responded that the Panel should compare treatment accorded under Section 907(a)(1)(A) to all

³⁷³See *supra*, paras. 97-101.

³⁷⁴Panel Report, para. 7.271.

imported cigarettes (to the extent they are like) and not just clove cigarettes, with the treatment accorded to all domestically produced like cigarettes.³⁷⁵

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.³⁷⁶ (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.³⁷⁷

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.³⁷⁸ 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.³⁷⁹

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.³⁸⁰ 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

³⁷⁵Panel Report, para. 7.272.

³⁷⁶Panel Report, para. 7.275.

³⁷⁷Panel Report, para. 7.277.

³⁷⁸United 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).

³⁷⁹United States' appellant's submission, para. 81.

³⁸⁰United States' appellant's submission, para. 79.

legitimate regulatory distinctions from those that serve as a proxy for singling out the like products of the complaining Member³⁸¹ 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.³⁸² 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.³⁸³

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.³⁸⁴ 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.³⁸⁵ 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.³⁸⁶

190. Article 2.1 provides that "products imported from the territory of *any Member*"³⁸⁷ 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

³⁸¹United States' appellant's submission, para. 84.

³⁸²United States' appellant's submission, para. 79.

³⁸³United States' appellant's submission, para. 87.

³⁸⁴Indonesia's appellee's submission, paras. 138 and 139.

³⁸⁵Indonesia's appellee's submission, paras. 123-130.

³⁸⁶Indonesia's appellee's submission, paras. 147 and 148.

³⁸⁷Emphasis 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.³⁸⁸

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.³⁸⁹ (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

³⁸⁸See Appellate Body Report, *EC and certain member States – Large Civil Aircraft*, para. 1131.

³⁸⁹Appellate 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.³⁹⁰

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.³⁹¹ The Panel also observed that only "a small percentage of non-clove cigarettes" was imported from Indonesia into the United States.³⁹² 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

³⁹⁰Panel Report, paras. 7.275-7.276.

³⁹¹Panel Report, para. 7.275.

³⁹²Panel 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 cigarettes³⁹³—and accordingly limited its less favourable treatment analysis to a comparison of the treatment accorded to those two product groups.³⁹⁴ 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"³⁹⁵ 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".³⁹⁶ 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".³⁹⁷ 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.

³⁹³Panel Report, para. 7.147.

³⁹⁴Panel Report, para. 7.277.

³⁹⁵Panel Report, para. 7.289.

³⁹⁶Panel Report, para. 2.28.

³⁹⁷United 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.³⁹⁸

(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".³⁹⁹ 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 2008.⁴⁰⁰ 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.⁴⁰¹

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.⁴⁰² 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.⁴⁰³

³⁹⁸United States' appellant's submission, paras. 97 and 98.

³⁹⁹United States' appellant's submission, para. 92.

⁴⁰⁰United States' appellant's submission, para. 93.

⁴⁰¹United States' appellant's submission, para. 94.

⁴⁰²Indonesia's appellee's submission, para. 151.

⁴⁰³Indonesia's appellee's submission, para. 152 (quoting United States's 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."⁴⁰⁴ 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.⁴⁰⁵

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.⁴⁰⁶ 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".⁴⁰⁷ Within these parameters, "it is generally within the discretion of the [p]anel to decide which evidence it chooses to utilize in making findings"⁴⁰⁸, and panels "are not required to accord to factual evidence of the parties the same meaning and weight as do the parties".⁴⁰⁹

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"⁴¹⁰, 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

⁴⁰⁴Panel Report, para. 7.289.

⁴⁰⁵United States' appellant's submission, paras. 97 and 98.

⁴⁰⁶Indonesia's appellee's submission, paras. 158 and 162.

⁴⁰⁷Appellate 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).

⁴⁰⁸Appellate Body Report, *EC – Hormones*, para. 135.

⁴⁰⁹Appellate Body Report, *Australia – Salmon*, para. 267.

⁴¹⁰Panel 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 cigarettes certified as "fire-safe". We therefore stand by our conclusion.⁴¹¹

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".⁴¹²

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.⁴¹³ 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 earlier⁴¹⁴, 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

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.⁴¹⁵

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"⁴¹⁶ 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.⁴¹⁷ (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.⁴¹⁸ 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.⁴¹⁹

⁴¹¹Panel Report, footnote 524 to para. 7.289.

⁴¹²United States' appellant's submission, para. 99 (referring to Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 96).

⁴¹³Panel Report, paras. 7.279-7.281.

⁴¹⁴See *supra*, paras. 174 and 175.

⁴¹⁵Panel Report, para. 7.289 and footnote 522 thereto.

⁴¹⁶Panel Report, para. 7.289.

⁴¹⁷Panel Report, para. 7.289.

⁴¹⁸United States' appellant's submission, para. 99.

⁴¹⁹United States' appellant's submission, para. 109.

(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.⁴²⁰ 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."⁴²¹ 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.⁴²² 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.⁴²³ 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.⁴²⁴ 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.⁴²⁵

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 2.1.⁴²⁶ 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.⁴²⁷ 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

disproportionate allocation of costs between Indonesian and US entities evidenced *de facto* discrimination against imports.⁴²⁸

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."⁴²⁹ 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"⁴³⁰ on the US market.⁴³¹

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.⁴³² The Panel also noted that the "vast majority" of clove cigarettes consumed in the United States came from Indonesia.⁴³³ 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)"⁴³⁴, 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".⁴³⁵ 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".⁴³⁶

⁴²⁸Indonesia's appellee's submission, paras. 184-185.

⁴²⁹Panel Report, para. 7.289.

⁴³⁰Panel Report, para. 7.289.

⁴³¹Moreover, 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.

⁴³²Panel 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)).

⁴³³Panel 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 FSPTCA. (*Ibid.* (referring to United States' first written submission to the Panel, para. 35))

⁴³⁴Panel Report, footnote 58 to para. 2.28.

⁴³⁵Panel Report, para. 2.28.

⁴³⁶United 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 produced⁴³⁷, and that menthol cigarettes accounted for about 26 per cent of the total US cigarette market.⁴³⁸ 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.⁴³⁹

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.⁴⁴⁰ To the extent that this particular characteristic is present in both clove and menthol cigarettes⁴⁴¹, 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;

⁴³⁷Cigarettes: Domestic and Imported, 2000-2009 (Panel Exhibit US-31).

⁴³⁸United 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)).

⁴³⁹See 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.

⁴⁴⁰Panel Report, paras. 7.216-7.221.

⁴⁴¹Panel 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 addictive 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.⁴⁴² 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.⁴⁴³

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.⁴⁴⁴

⁴⁴²United States' appellant's submission, para. 110.

⁴⁴³United States' appellant's submission, para. 111.

⁴⁴⁴Indonesia'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."⁴⁴⁵ 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.⁴⁴⁶ 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

⁴⁴⁵Appellate 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.

⁴⁴⁶United 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 Concerns⁴⁴⁷ ("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*.⁴⁴⁸ 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)".⁴⁴⁹

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

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*.⁴⁵⁰

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".⁴⁵¹

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.⁴⁵² 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*.⁴⁵³ 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 32 of the *Vienna Convention*.⁴⁵⁴

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*.⁴⁵⁵

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

⁴⁴⁷Decision of 14 November 2001, WT/MIN(01)/17, para. 5.2.

⁴⁴⁸Panel Report, para. 7.552.

⁴⁴⁹Panel Report, para. 7.561. (original emphasis)

⁴⁵⁰Panel Report, para. 7.576.

⁴⁵¹Panel Report, para. 7.576.

⁴⁵²United States' appellant's submission, para. 124 (referring to Panel Report, para. 7.576).

⁴⁵³United States' appellant's submission, para. 129.

⁴⁵⁴United States' appellant's submission, para. 126.

⁴⁵⁵Indonesia's appellee's submission, para. 222. (original emphasis)

binding".⁴⁵⁶ 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*.⁴⁵⁷

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*.⁴⁵⁸

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*".⁴⁵⁹

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*.

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 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.

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".⁴⁶⁰ 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 1 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 1 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

⁴⁵⁶Emphasis added.

⁴⁵⁷Indonesia's appellee's submission, para. 222.

⁴⁵⁸United States' appellant's submission, para. 124.

⁴⁵⁹Indonesia's appellee's submission, para. 222.

⁴⁶⁰Appellate Body Reports, *EC – Bananas III (Article 21.5 – Ecuador II) / EC – Bananas III (Article 21.5 – US)*, para. 383.

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.⁴⁶¹ 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*.⁴⁶² 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."⁴⁶³

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*".⁴⁶⁴ 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 Multilateral Trade Agreement contained in Annex 1 to the *WTO Agreement* "on the basis of a

⁴⁶¹Panel Report, para. 7.574 (referring to United States' response to Panel Question 6, para. 5). (emphasis added)

⁴⁶²Panel Report, para. 7.575.

⁴⁶³United States' appellant's submission, para. 125.

⁴⁶⁴Panel Report, para. 7.575.

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 Declaration⁴⁶⁵ 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.⁴⁶⁶ 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*.⁴⁶⁷

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*".⁴⁶⁸

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 observe that multilateral interpretations adopted pursuant to Article IX:2 of the *WTO Agreement*, on

⁴⁶⁵Adopted on 14 November 2001, WT/MIN(01)/DEC/1.

⁴⁶⁶Panel Report, para. 7.574 (referring to Indonesia's response to Panel Question 6, para. 27).

⁴⁶⁷In 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*.

⁴⁶⁸Panel Report, para. 7.576. (footnote omitted)

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.⁴⁶⁹ 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"⁴⁷⁰, 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*".⁴⁷¹ Thus, given the specific function of multilateral interpretations adopted pursuant to Article IX:2, and the fact that these interpretations are adopted by

⁴⁶⁹In *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))

⁴⁷⁰Appellate Body Reports, *EC – Bananas III (Article 21.5 – Ecuador II) / EC – Bananas III (Article 21.5 – US)*, para. 383.

⁴⁷¹Appellate Body Reports, *EC – Bananas III (Article 21.5 – Ecuador II) / EC – Bananas III (Article 21.5 – US)*, para. 390. (emphasis added)

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."⁴⁷² 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 Article 2.12 of the *TBT Agreement* is expressed by terms—"shall be understood to mean"—that cannot be considered as merely hortatory.

⁴⁷²Appellate Body Reports, *EC – Bananas III (Article 21.5 – Ecuador II) / EC – Bananas III (Article 21.5 – US)*, para. 390. (emphasis added)

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".⁴⁷³ 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

⁴⁷³*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.

adapt their products or methods of production" to the requirements of the importing Member's technical regulation.⁴⁷⁴ 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.⁴⁷⁵ We observe that the ordinary meaning of the term "normally" is defined as "under normal or ordinary conditions; as a rule".⁴⁷⁶ 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.

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

⁴⁷⁴Panel Report, para. 7.582.

⁴⁷⁵United States' appellant's submission, para. 127.

⁴⁷⁶*Shorter Oxford English Dictionary*, 6th edn, A. Stevenson (ed.) (Oxford University Press, 2007), Vol. 2, p. 1945.

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 FFDCA was unreasonable in the light of its impact on the ability of Indonesian producers to adapt to the requirements of that measure.⁴⁷⁷ 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".⁴⁷⁸

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.⁴⁷⁹ 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.⁴⁸⁰

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,

⁴⁷⁷United States' appellant's submission, paras. 132-134.

⁴⁷⁸United States' appellant's submission, para. 135.

⁴⁷⁹United States' appellant's submission, para. 136.

⁴⁸⁰Indonesia's appellee's submission, para. 237.

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.⁴⁸¹

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

between the publication and the entry into force of the technical regulation at issue.⁴⁸² 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".⁴⁸³ 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.

⁴⁸²In *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:I, 323, at 335)

⁴⁸³Appellate Body Report, *US – Wool Shirts and Blouses*, p. 14, DSR 1997:I, 323, at 335.

⁴⁸¹United States' appellant's submission, para. 135.

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."⁴⁸⁴ 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.⁴⁸⁵

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.⁴⁸⁶

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

⁴⁸⁴Panel Report, para. 7.592.

⁴⁸⁵United States' appellant's submission, para. 143 (referring to Appellate Body Report, *EC – Sardines*, para. 288).

⁴⁸⁶We 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".⁴⁸⁷ 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).

⁴⁸⁷Panel 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".⁴⁸⁸ 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".⁴⁸⁹ 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".⁴⁹⁰ 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.⁴⁹¹ 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".⁴⁹² Before the Panel, the United States argued that the

⁴⁸⁸Panel Report, para. 7.507.

⁴⁸⁹Panel Report, para. 7.583 (referring to United States' first written submission to the Panel, para. 303).

⁴⁹⁰Panel Report, para. 7.583.

⁴⁹¹United States' appellant's submission, para. 153.

⁴⁹²Panel Report, para. 7.593.

FSPTCA "directly addresses a serious problem—youth smoking" and that "Congress intended to limit this behaviour as much as practicable".⁴⁹³ 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

⁴⁹³Panel 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 Ramírez-Hernández
Member

Peter Van den Bossche
Member

**WORLD TRADE
ORGANIZATION**

**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"),¹ is inconsistent with Article 2.1 of the *Agreement on Technical Barriers to Trade* (the "TBT Agreement").² 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.³ 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.⁴ Specifically the Panel erred by failing to perform a complete analysis of the end-uses⁵ of clove cigarettes and menthol cigarettes and failing to perform a complete

¹The 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).

²See, e.g., Panel Report, paras. 7.293, 8.1(b).

³See, e.g., Panel Report, para. 7.248.

⁴See, e.g., Panel Report, paras. 7.116, 7.119, 7.197-199, 7.206, 7.209-210, 7.214, 7.230-231.

⁵See, e.g., Panel Report, paras. 7.197-199.

analysis of consumer tastes and habits.⁶ 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.⁷

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.⁸ 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,⁹ 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.¹⁰ 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.¹¹ 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,¹² and that Section 907(a)(1)(A) imposes no costs on any U.S. entity.¹³

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.¹⁴ 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.¹⁵

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 ...".¹⁶ 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.

⁶See, e.g., Panel Report, paras. 7.116, 7.119, 7.206-7.232.

⁷See, e.g., Panel Report, para. 7.210.

⁸See, e.g., Panel Report, para. 7.292.

⁹See, e.g., Panel Report, paras. 7.274, 7.277.

¹⁰See, e.g., Panel Report, para. 7.289.

¹¹See, e.g., Panel Report, paras. 7.269, 7.286-7.291.

¹²See, e.g., Panel Report, para. 7.289.

¹³See, e.g., Panel Report, para. 7.289.

¹⁴See e.g., Panel Report, paras. 7.595, 8.1(h).

¹⁵See e.g., Panel Report, paras. 7.561-7.595.

¹⁶Panel Report, paras. 7.351-7.369.