**WTO CASE REVIEW 2005**[#]

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# This *WTO Case Review* is the sixth in our annual series on the substantive international trade adjudications issued by the Appellate Body of the World Trade Organization. Each *Review* explains and comments on the Appellate Body reports adopted by the WTO Dispute Settlement Body during the preceding calendar year (1 January through 31 December), excluding decisions on compliance with recommendations contained in previously adopted reports. Our preceding *Reviews* are:

- *WTO Case Review 2004*, 22 ARIZ. J. INT'L & COMP. L. 99-249 (2005).
- *WTO Case Review 2003*, 21 ARIZ. J. INT'L & COMP. L. 317-439 (2004).
- *WTO Case Review 2002*, 20 ARIZ. J. INT'L & COMP. L. 143-289 (2003).
- *WTO Case Review 2001*, 19 ARIZ. J. INT'L & COMP. L. 457-642 (2002).
- *WTO Case Review 2000*, 18 ARIZ. J. INT'L & COMP. L. 1-101 (2001).

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The WTO reports we discuss are available on the web site of the WTO, www.wto.org. The texts of the WTO agreements we discuss are available on this web site, and published in a variety of sources, including Raj Bhala, *International Trade Law Handbook* (2d ed. 2001). We endeavor to minimize footnotes and, toward that end, provide citations to indicate sources from which various portions of our discussion are drawn.

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**PART ONE: INTRODUCTION**



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**I. GATT Obligations**

## PART ONE: INTRODUCTION

### I. BUSINESS AS USUAL FOR THE APPELLATE BODY

It was a busy year for the Appellate Body and for WTO Members appearing before it. Ten new cases were filed (including Article 21.5 reviews), more than in any year except 2000.[1] The total number of cases appealed, as a percentage of panel decisions, was sixty-five percent, near the ten year historical average of sixty-eight percent.[2] Forty-two WTO Members appeared at least once as appellant, appellee, or third-party participant, of which six were developed country members (including the EU) and thirty-six were developing country members.[3] Over the ten year history of the Appellate Body, sixty-six of 149 WTO Members have participated in at least one appeal, and twelve have participated in ten or more cases: Argentina, Australia, Brazil, Canada, China, the European Communities, India, Japan, Mexico, New Zealand, Thailand and the United States.[4]

Compliance with WTO decisions remains relatively high, although problems continue in some cases, as noted in the various case summaries, *infra*. The United States, among others, has made major efforts to comply in two significant cases, with some success. The United States purportedly complied with *EC – Foreign Sales Corporation*, a dispute over U.S. tax laws of more than eight years' duration.[5] However, the extent of compliance was successfully challenged by the EC, because the U.S. legislation had permitted corporate beneficiaries of the tax break to continue to enjoy its benefits until the end of 2006.[6] The EC has threatened to reinstate sanctions.[7] In another major case, *US – Byrd Amendment*,[8] decided in early 2003, President Bush's continuing efforts to

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1. Appellate Body Report, *Annual Report for 2005*, Annex 2, WT/AB/5 (Jan. 25, 2006).
2. *Id.* at Annex 3. (The *Report* contains many details of Member participation and short summaries of each of the Appellate Body decisions.)
3. *Id.* at 6.
4. *Id.* at Annex 4.
5. Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations,"* WT/DS108/AB/R (Feb. 24, 2000) (the Panel request was originally made on July 1, 1998).
6. *See* Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations:" Second Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW2 (*circulated* Feb. 13, 2006).
7. Daniel Pruzin, *WTO Appeals Body Finds U.S. Not Complying in FSC/ETI Ruling; EU Threatens Sanctions*, 23 INT'L TRADE REP. (BNA) 226 (Feb. 16, 2006).
8. Appellate Body Report, *United States – Continued Dumping and Subsidy Offset Act of 2000*, WT/DS217, 234/AB/R (Sept. 2, 2002).

secure repeal of the Amendment were fruitful in February 2006.[9] The legislation, once implemented, will likely relieve U.S. exporters to the EU, Canada, Japan and Mexico of $144 million annually in retaliatory tariffs. Nevertheless, the issue may not be fully resolved, as the repeal is not immediate, but instead permits the United States to continue dispersing the collected dumping duties to U.S. domestic industries protected by anti-dumping and countervailing duty orders through October 1, 2007.[10] On that basis, the complaining parties have indicated their intention to keep the sanctions in place.[11]

U.S. compliance remains mired in controversy in at least one other major case, *US – Softwood Lumber ITC*.[12] In that action, the United States responded to an earlier Panel decision finding the United States International Trade Commission (USITC) determination of a threat of material injury to be inconsistent with WTO rules.[13] At the request of the U.S. Trade Representative,[14] the USITC reopened the record of the investigation, and ultimately rendered a second decision that also found that softwood lumber imports from Canada threatened the domestic industry with material injury.[15] Based on this second determination, and the Panel's conclusion that it was compliant,[16] the United States has kept the anti-dumping and countervailing orders in force, and Canada has appealed the compliance panel decision to the Appellate Body.[17] In a separate challenge, a WTO compliance panel rejected a Canadian challenge to the U.S. Department of Commerce's (USDOC) "zeroing" methodology in the calculation of anti-dumping duties.[18]

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9. *See* Rossella Brevetti, *House Approves Budget Measure Containing Byrd Amendment Repeal*, 23 Int'l Trade Rep. (BNA) 184 (Feb. 2, 2006) (discussing the long process resulting in enactment of the legislation).

10. *Id.*

11. Daniel Pruzin, *Trading Partners Reject U.S. Claims of WTO Compliance in Byrd Act Dispute*, 23 INT'L TRADE REP. (BNA) 260 (Feb. 23, 2006).

12. Panel Report, *United States – Investigation of the International Trade Commission in Softwood Lumber from Canada*, WT/DS277/RW (Nov. 15, 2005) [hereinafter *Softwood Lumber* Panel Report].

13. Panel Report, *United States – Investigation of the International Trade Commission in Softwood Lumber from Canada: Recourse to Article 21.5 of the DSU by Canada*, WT/DS277/R (Nov. 15, 2005).

14. Authority for U.S. agencies to comply with WTO rulings is provided in The Uruguay Round Agreements Act, 19 U.S.C. § 3538(a) (1994). These are commonly referred to as "section 129" proceedings.

15. *Softwood Lumber* Panel Report, *supra* note 12, ¶¶ 2.1-10, 7.1-10.

16. *Id.* ¶¶ 7.57, .62-63, .74.

17. *See generally* Daniel Pruzin, *Canada Appeals WTO Ruling Upholding ITC Determination on Canadian Lumber*, 23 INT'L TRADE REP. (BNA) 83 (Jan. 19, 2006).

18. *See generally* Daniel Pruzin & Peter Menyasz, *U.S. Industry Welcomes WTO Interim Ruling on U.S. Compliance With Lumber AD Ruling*, 23 INT'L TRADE REP. (BNA) 287 (Feb. 23, 2006).

Controversy over *EC – Bananas*,[19] another long-running dispute, also continues. Most recently, Honduras, Nicaragua and Panama requested consultations with the EC under DSU Article 21.5, regarding the EC's decision to impose a tariff of €176 per metric ton in lieu of an earlier tariff rate quota.[20] Some Latin American exporters have argued in negotiations for a tariff of €75 per ton, and consultations are continuing.

What is perhaps most notable about the Appellate Body's 2005 decisions is that three of the eight focus largely on trade in agricultural products, *EC – Chicken Parts*, *EC – Sugar Subsidies* and *US – Upland Cotton*, all reviewed *infra.* It is presumably more than coincidence that as the nearly 150 members of the WTO struggle to move forward in the Doha Development Round—largely because of the difficulties of dealing with domestic and export subsidies related to agricultural products and with agricultural market access—several key decisions applying and interpreting the WTO Agreement on Agriculture may have reduced the negotiators' flexibility (and underscored the urgency) in dealing with these thorny issues.

## PART TWO: DISCUSSION OF THE 2005 CASE LAW FROM THE APPELLATE BODY

### I. GATT OBLIGATIONS

#### A. Pillar Obligations

1. Citation

*Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes*, WT/DS302/AB/R (issued April 25, 2005, adopted May 19, 2005) (complaint by Honduras, with China, EC, El Salvador, Guatemala and the United States as third parties).

2. Introduction and Explanation

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19. Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R (Sept. 9, 1997).

20. *See Update of WTO Dispute Settlement Cases*, WT/DS/OV/25, at 213-217 (Dec. 12, 2005), *available at* http://www.wto.org/english/tratop_e/dispu_e/dispu_e.htm#annualoverview (follow "find latest update" hyperlink; then follow "preview HTML" hyperlink) [hereinafter *WTO Dispute Update*]. The tariff rate quota had provided for an in-quota duty of €75/mt and a €680/mt rate for beyond quota imports. *See* Daniel Pruzin, *EU, Latin America Exporters Discuss New Banana Tariff; Latins Unimpressed*, 22 INT'L TRADE REP. (BNA) 2065 (Dec. 22, 2005).

a. The Case Below

It is not often these days that the DSB has the opportunity to review a blatant discrimination case under Article III of the GATT (and the Article XX exceptions), with issues arising under Articles II and XI to boot. Perhaps it is not surprising that it involved a manufactured tobacco product; cigarettes produce significant tax revenues in most countries, and where there is a domestic industry it is frequently protected by the local government.[21] In January 2004, Honduras requested a DSU panel that challenged the GATT legality of five measures taken by authorities in the Dominican Republic (DR) relating to the importation and internal sale of cigarettes.[22] Most but not all of the measures were cigarette-specific. They included:[23]

- a two percent tariff surcharge on all imports into the Dominican Republic
- a foreign exchange fee at the stiff rate of [ten percent] imposed by the Monetary Board for mandatory conversion of currency
- a legal requirement that the tax stamps for cigarette packages be affixed to the packages <u>in</u> the territory of the Dominican Republic, rather than at the place of manufacture, export or elsewhere
- certain allegedly discriminatory rules and administrative practices used by Dominican authorities to determine the tax base for the Selective Consumption Tax as that tax was applied to cigarettes
- a bonding requirement applicable to cigarette importers, allegedly to ensure that the importers would pay all taxes due, even though import duties were paid at the time of importation.

As discussed in more detail below, the Panel found in all significant respects in favor of Honduras, determining violations of GATT Articles II:1, III:4 and XI:1.[24] The DR appealed.[25]

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21. *See* Panel Report, *Thailand – Restrictions on Importation of and Internal Taxes on Cigarettes*, DS10/R – 37S/200 (Oct. 5, 1990) (involving a dispute between Thailand and the United States over U.S. cigarette exports to Thailand).

22. Appellate Body Report, *Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes*, WT/DS302/AB/R (Oct. 20, 2004) [hereinafter *Cigarettes* Appellate Body Report].

23. Panel Report, *Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes*, WT/DS302/R, ¶¶ 2.1-.6 (Nov. 26, 2004) [hereinafter *Cigarettes* Panel Report].

24. *Cigarettes* Appellate Body Report, *supra* note 22, ¶¶ 2-4.

25. *Id.* ¶ 5.

b. Issues Raised on Appeal[26]

Essentially the same issues were raised on appeal, with a slightly different legal focus in some instances:

> (a) whether the Panel erred in finding that the tax stamp requirement was not justified under Article XX(d) of GATT, based on the application of the term "necessary" in that provision;
> (b) whether the Panel failed to make an objective assessment of the facts, under Article 11 of the DSU, in examination of certain exhibits;
> (c) whether the Panel erroneously concluded that Honduras had failed to establish that the bonding requirement "accords less favorable treatment to imported cigarettes than that accorded to like domestic products," under Article III:4 of GATT;
> (d) whether the Panel acted inconsistently with Article 11 of the DSU in considering Honduras' claim against the bonding requirement "as such;" and
> (e) whether the Panel erred in finding that Honduras' contentions on timing of payment of the Selective Consumption Tax was a separate claim outside of the Panel's terms of reference.

Obviously, (a) and (c) are the critical issues.

3. Holdings and Rationale

a. The Necessity Analysis under GATT Article XX(d)[27]

One of the principal GATT violations raised by Honduras was the DR's requirement that the tax stamps be fastened to cigarette packets in the territory of the DR under the supervision of the DR's tax authorities. This was, according to Honduras, a complicated and expensive process, requiring *inter alia*, the importer to reopen the boxes and cartons of imported cigarettes, cut the tax stamps, glue the individual stamps on the cigarette packs, and repack the boxes and cartons. Aesthetics were adversely affected because the stamp was affixed over rather than under the cellophane wrappers. The cost of affixing the stamp in the DR was \$0.90 per thousand cigarettes, compared to \$0.10 per thousand if done in Honduras. Assuming that the costs for a DR producer affixing the stamp in the

26. *Id.* ¶ 56.
27. *Id.* ¶¶ 57-74.

DR, as part of the manufacturing process, are similar to the costs in Honduras, imported cigarettes are treated less favorably.[28]

For obvious reasons, the Panel found the stamp requirement to be inconsistent with the non-discrimination provisions of Article III:4,[29] because it modified the terms of competition to the detriment of importers and led to the presentation of the cigarettes in a less appealing manner. The Panel then examined the DR's contention that the requirement was "necessary" under GATT Article XX(d) in order to secure compliance with DR tax laws, fight tax evasion through forgery of tax stamps, and discourage smuggling. However, the Panel concluded that the DR had failed to demonstrate that the stamp requirement was justified under Article XX(d).[30] The DR did not appeal the Article III finding, but challenged the rejection by the Panel of the applicability of Article XX(d), which provides in pertinent part:

> 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 . . . .

While the Panel agreed that the collection of tax revenues was very important to the DR, and that the restrictive impact on trade was not "intense," it found no causal link between forgery and the attachment of tax stamps. Nor did the DR demonstrate why other, GATT consistent or less GATT inconsistent, measures would not meet the needs of the tax authorities. For example, the DR might have provided secure tax stamps to foreign cigarette exporters. Thus, according to the Panel, the affixing requirement did not meet the "necessary" criterion of Article XX(d).[31] The DR asserted that the Panel failed to examine all relevant factors, including whether the affixing of tax stamps abroad might permit smuggling without payment of DR import duties. The so-called alternative measure was not a reasonably available alternative because it would not deal effectively with problems of tax evasion. The United States supported the DR in

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28. *Cigarettes* Panel Report, *supra* note 23, ¶¶ 4.31-.34 (stating the Honduran legal arguments).
29. *Id.* ¶¶ 7.198, 8.1(e).
30. *Id.* ¶¶ 7.232-.233, 8.1(e).
31. *Cigarettes* Appellate Body Report, *supra* note 22, ¶ 59.

part, by arguing that there is a requirement under Article XX(d) of a less trade restrictive measure and that nothing justifies a requirement of a less trade restrictive, but still GATT-inconsistent, measure. In any event, according to the United States, Members may select their own level of protection insofar as such risks are concerned, with a measure that involves continuation of the risk not a reasonably available alternative.[32]

By the time of the Appellate Body's oral hearing, this aspect of the case appeared to be moot, since the DR had modified its tax requirements to allow affixing the stamp at the time and place of production. However, both parties requested the Appellate Body to rule, and the Appellate Body obliged.[33] The Appellate Body began by reminding that the analysis under Article XX was two-tiered, in that the measure must not only come under one of the subparagraphs (a) to (j), but also under the introductory clauses of the article. Thus, for justification under paragraph (d), "[f]irst, the measure must be one designed to 'secure compliance' with laws or regulations that are not in themselves inconsistent with some provision of the GATT 1994. Second, the measure must be 'necessary' to secure such compliance."[34]

This process, the Appellate Body emphasized, involves in each case a weighing and balancing of a series of factors.[35] One issue raised by this approach is whether any alternative measure "contributes to the realization of the end pursued" and the importance of the vital nature of the interests or values pursued.[36] In general, based on various earlier decisions, the Appellate Body reiterated that in the assessment of a proposed alternative, "factors such as the trade impact of the measure, the importance of the interests protected by the measure, or the contribution of the measure to the realization of the end pursued, should be taken account in the analysis." This also "informs the decision" as to whether there is a WTO-consistent measure or a less WTO-inconsistent measure, available.[37] In general, the Panel's assessment of these factors, including the availability of alternative WTO-consistent measures (such as providing secure tax stamps to foreign producers) was not in error. Thus, the Panel's finding that the tax measures are not "necessary" under Article XX(d) was upheld.

#### b. Conformity of Certain Exhibits with DSU Article 11[38]

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32. *Id.* ¶ 54.
33. *Id.* ¶ 63.
34. *Id.* ¶¶ 64-65 (quoting *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/AB/R, WT/DS162/AB/R, ¶ 157 (adopted Jan. 10, 2001)).
35. *Id.* (citing *Korea – Various Measures on Beef*, ¶ 164).
36. *Id.* (quoting from *Korea – Various Measures on Beef*, ¶¶ 170, 166, 163).
37. *Cigarettes* Appellate Body Report, *supra* note 22, ¶ 70.
38. *Id.* ¶¶ 75-85.

The DR had attempted to demonstrate with certain exhibits that where tax stamps were affixed by the manufacturer of alcoholic beverages abroad, smuggling into DR territory and the use of forged tax stamps had occurred. According to the DR, the Panel had misread or misunderstood some of this evidence, and erroneously rejected the causal link between affixing these stamps abroad and the smuggling and counterfeiting problems, to the point where the "objective assessment" requirement of DSU Article 11 had not been met.[39] However, the Appellate Body was not convinced that any possible errors by the Panel amounted to a violation of Article 11, citing various earlier decisions (particularly *EC – Asbestos)* holding that Panels, as triers of fact, "enjoy a 'margin of discretion'" and may properly "determine that certain elements of evidence should be accorded more weight than other evidence."[40] The Appellate Body reiterated its view, again based on *EC-Asbestos*, that under Article 11, the Appellate Body will not "second-guess the Panel in appreciating either the evidentiary value of . . . studies or the consequences, if any, of alleged defects in [the evidence]."[41]

For the Appellate Body, the "facts" presented by the DR exhibits were sufficiently weak—there was no conclusive evidence that the alcoholic beverage stamps had been forged, and the documented seizure was in 2001, while the assertions concerned stamps for which the format had been established in 2002—so that it was within the Panel's discretion not to treat the evidence as conclusive, and was therefore consistent with the requirements for panels in Article 11 of the DSU.[42] Other DR complaints with regard to the Panel's assessment of the evidence in the exhibits, drawing of inferences, and rejecting a causal link were rejected in the same manner by the Appellate Body.

### c. The Bonding Requirement and GATT Article III:4[43]

With regard to the DR requirement that importers of cigarettes post a bond to ensure payment of taxes, the Panel had found in favor of the DR. Honduras had argued that the requirement that importers post a bond against payment of taxes (primarily the Selective Consumption Taxes) constitutes a restriction of imports in violation of GATT Article XI.[44] Honduras argued in the alternative that the bonding scheme afforded less favorable treatment to imported cigarettes than to domestic cigarettes, in that importers were required to post the

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39. *Id.* ¶¶ 75, 80.
40. *Id.* ¶ 78 (quoting *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, ¶ 161 (*adopted* Apr. 5, 2001)).
41. *Id.* ¶ 79 (quoting *from EU – Asbestos*, Appellate Body Report, ¶ 86).
42. *Id.* ¶ 81.
43. *Cigarettes* Appellate Body Report, *supra* note 22, ¶¶ 86-100.
44. *Cigarettes* Panel Report, *supra* note 23, ¶ 4.51.

bond even though all taxes were paid upon importation while domestic producers only paid the taxes on the 20th of the month following sale of the cigarettes. Also, the fixed bonding amount of RD $5 million bears no direct relationship to actual tax liability.[45] These, according to Honduras, imposed "extra burdens" on imported products.[46] The DR argued, in contrast, that a finding of a violation of GATT, Article III:4 requires analysis of the "'thrust and effect' of the measure on conditions of competition in the relevant market," and that, consequently, a showing of "formally different treatment" is not sufficient. Rather, there is no violation unless the measure "modifies the conditions of competition to the detriment of importers" and "gives domestic producers a competitive advantage."[47]

The Panel essentially agreed with the DR. It concluded that "the bond requirement is applied in an equal manner, both formally and in practice, to domestic and imported cigarettes" and that "Honduras had failed to establish that the bond requirement . . . accords less favourable treatment to imported cigarettes than that accorded to the like domestic products, in a manner inconsistent with Article III:4" of the GATT.[48] According to the Appellate Body, the Panel reasoned that if a local company wished to purchase cigarettes, it could purchase them either from a local producer or an importer; in neither case would the local purchaser have to post a bond. The Panel rejected Honduras' argument that there was no tax liability subject to bond, noting that DR tax authorities had up to three years to readjust the tax liabilities.[49] The Panel ultimately concluded that the differential cost of the bonding requirement was not shown to have a "detrimental impact on competitive conditions for imported products in relation to domestic products in the DR cigarette market."[50]

GATT, Articles III:1 and III:4 are both relevant to the discussion. Article III:1 provides in pertinent part 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.

Article III: 4 provides:

45. *Id.* ¶¶ 4.52-.53.
46. *Cigarettes* Appellate Body Report, *supra* note 22, ¶ 30.
47. *Id.* ¶ 37.
48. *Cigarettes* Panel Report, *supra* note 23, ¶ 7.311.
49. *Cigarettes* Appellate Body Report, *supra* note 22, ¶ 87.
50. *Cigarettes* Panel Report, *supra* note 23, ¶ 7.301.

> The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.

The Appellate Body began its analysis by noting the requirement set out in its report in *Korea – Various Measures on Beef*, namely that determining whether imports "are treated 'less favorably' than like domestic products should be assessed . . . by examining whether a measure modifies the *conditions of competition* in the relevant market to the detriment of imported products."[51] Moreover, "[t]he 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.'"[52] In other words, the Appellate Body said, "a measure accords less favourable treatment to imported products if it gives domestic like products a competitive advantage in the market over imported like products."[53]

Here, the same RD $5 million bonding requirement applies equally to importers and domestic producers. Also, as the Panel found, the tax authorities have legal authority to reassess the tax amounts, so that the bond posted for imports "would serve to guarantee any payment resulting from the reassessment."[54] In addition, the DR authorities, according to the Panel, may use the bond to enforce payment of other tax liabilities, beyond the Selective Consumption Tax. The Appellate Body accepted this Panel conclusion, and noted in addition that to the extent there is a disadvantage for imported products, it is based on other factors (higher Selective Consumption Tax, because the tax is based on market share), rather than on the foreign origin of the product. Significantly, the Appellate Body concluded that:

> [T]he existence of a detrimental effect on a given imported product resulting from a measure does not necessarily imply that this measure accords less favourable treatment to imports if the detrimental effect is explained by factors or circumstances unrelated to the foreign origin of the product . . . . [T]he mere demonstration that the per-unit cost of the bond requirement for imported cigarettes was higher than for some domestic cigarettes during a particular period it is not, in our view *sufficient* to

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51. *Cigarettes* Appellate Body Report, *supra* note 22, ¶ 91 (quoting *Korea – Various Measures on Beef*, Appellate Body Report, ¶ 137 (emphasis in original)).
52. *Id.* ¶ 92 (quoting *EC-Asbestos*, Appellate Body Report, ¶ 100).
53. *Id.* ¶ 93.
54. *Id.* ¶ 94 (referring to *DR – Cigarettes*, Panel Report, ¶ 7.294).

> establish 'less favourable treatment' under Article III:4 of the *GATT* 1994.[55]

As the Appellate Body observed, the per unit costs of the bond (a fixed amount of RD $5 million) would be higher when the foreign (Honduran) producer had a smaller market share than a domestic producer, since the per unit cost of the bond comes from dividing the cost of the bond by the number of cigarettes sold in the DR market. The Panel, therefore, was correct in dismissing Honduras' argument that under the bonding requirement imported cigarettes were accorded less favorable treatment.

The Appellate Body also rejected Honduras' other objections, including the fact that the panel used old (2001-2003) data for making its "illustrative" evaluation of the per unit cost of the bond fee. Moreover, given that the bond represented only about 0.2% of the value of cigarette imports, there is a sense that the Panel and the Appellate Body both viewed this "very small cost for the importer" as insignificant. As long as such costs do not alter the conditions of competition, "that fact [the allocation of the fixed bond over differing cigarette market shares] in itself should not be enough to conclude that the expense creates a less favourable treatment for imported products."[56]

#### d. The Bonding Requirement "As Such" and DSU[57] Article 11[58]

A related issue concerned Honduras' contention that the bond in actuality served only to guarantee payment of the Selective Consumption Tax, which was payable at the time of importation; hence, there was no need for a bond.[59] The DR, in opposition, countered that the bond could secure payment of the tax amounts in the event that the amounts were adjusted post-importation, and that in practice it would secure "compliance with other internal tax obligations."[60] The Panel essentially accepted the DR's position, as noted in part (c), above. On appeal, Honduras claimed that this result constituted a failure to make an "objective assessment" under DSU Article 11, and that it was challenging the bonding requirement *as such*, apart from the application of the bonding legislation in specific circumstances, faulting the Panel for having relied on "unsubstantiated

55. *Id.* ¶ 96.
56. *Id.* ¶ 98.
57. Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, Legal Instruments – Results of the Uruguay Round, 33 I.L.M. 1125 (1994) [hereinafter DSU].
58. *Cigarettes* Appellate Body Report, *supra* note 22, ¶¶ 101-115.
59. *Cigarettes* Panel Report, *supra* note 23, ¶ 7.284.
60. *Id.* ¶ 7.285.

views" of the Director General of Internal Taxes[61] rather than on the legislative provision, for the proposition that the bond applied to other taxes in addition to the Selective Consumption Tax.

The Appellate Body agreed that *as such* claims against legislation are permitted under the DSU, and this was Honduras' intent in the present case. However, according to the Appellate Body, there was no evidence in the record to suggest that the Panel failed to consider the challenge to the bonding requirement *as such,* or even considered particular applications of the measure.[62] As to the nature of the evidence considered by the Panel (relating to whether the bond was limited to the Selective Consumption Tax or had broader application), the Appellate Body agreed with Honduras. Citing its decision in *US – Carbon Steel*, the Appellate Body reiterated its view that the Panel had a responsibility to consider the legislation and related legal instruments in determining the meaning of municipal laws.[63] That being said, the Panel was not required to limit itself to the text of the law itself, but was permitted, in exercising its discretion, to look to other relevant evidence, in this instance the letter from the DR official. Moreover, according to the Appellate Body, once the DR official's letter had been submitted by the DR, Honduras did not introduce any rebuttal evidence, with the Appellate Body here indirectly suggesting that the burden of proof had shifted to Honduras. The Panel was correct in considering all the evidence before it; as a result, its analysis met the "objective assessment" requirements of DSU Article 11.[64]

#### e. Timing of the Payment of the Selective Consumption Tax[65]

Another element of discrimination between imported and domestically produced cigarettes claimed by Honduras was that domestic producers did not have to pay the Selective Consumption Tax until the 20th day of the month following the sale, while importers paid the tax immediately upon importation. As Honduras observed, "[t]his entails either financing costs or opportunity costs on the part of the importers."[66] The Panel, as noted earlier, rejected Honduras' claims, accepting the DR's contention that the bond secured the payment of other taxes. The Panel also determined that claims based on financing costs were distinct from those based on the bonding requirement, and had not been raised in

61. *Id.* ¶ 7.291.
62. *Cigarettes* Appellate Body Report, *supra* note 22, ¶¶ 107-108.
63. *Id.* ¶ 111 (citing Appellate Body Report, *United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany*, WT/DS213/AB/R, ¶ 157 (Nov. 28, 2002) [hereinafter *Carbon Steel* Appellate Body Report]).
64. *Cigarettes* Appellate Body Report, *supra* note 22, ¶¶ 113-115.
65. *Id.* ¶¶ 116-127.
66. *Cigarettes* Panel Report, *supra* note 23, ¶¶ 7.268, .284.

the request for establishment of the panel. Therefore, that claim was outside the Panel's scope of reference.[67]

The Appellate Body began by noting that under DSU Article 6.2, a request for a panel must be in writing, indicate that consultations were held, and "identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly." This, under *US – Carbon Steel*, requires "identification of the specific measures at issue and the provision of a brief summary of the legal basis of the complaint."[68] Where a panel request "fails to specify a particular claim, then such measures or claims will not form part of the matter covered by the panel's terms of reference."[69]

However, there is a difference between the *claims* presented and the *arguments* made in support of those claims. Here, were the assertions regarding the effect of different tax payment schedules new claims, or arguments in favor of the already asserted GATT Article III:4 claim? According to the Appellate Body, it does not matter; the Panel decision indicates that the Panel addressed the timing arguments in the context of finding that importers bear liabilities secured by the bond, even though it did not do so "specifically and in detail." Under those circumstances, the Panel committed no error.[70] To the extent that Honduras' timing allegations were a separate claim of a violation of GATT, Article III:4, this was a claim not mentioned in the request for a panel, and was correctly determined to be outside the Panel's term of reference.

#### 4. Commentary

The determination that very small differences in the per unit cost of a bonding requirement that on its face applied equally to imported and domestic cigarettes does not constitute "less favorable treatment" under Article III:4 seems justified under the facts of the case. However, the implications are somewhat unsettling in terms of future cases that may also involve national treatment issues. Is there an implicit *de minimis* exception to what some may have thought was an absolute standard set by language of Article III:4—in which importers "shall be accorded treatment no less favourable than that accorded to like products of national origin?" Does the reason for the "detrimental effect" really matter, i.e., it may be excused if the measure is not related to the foreign origin of the product, so that the issue is really one of *de facto* discrimination? Would it have mattered if the incidence of the bond was 1.0% or 2.0% instead of 0.2%? In other cases, such as *Chile – Alcoholic Beverages*, discrimination was found even when the

67. *Id.* ¶ 7.308.
68. *Cigarettes* Appellate Body Report, *supra* note 22, ¶ 120 (quoting *Carbon Steel* Appellate Body Report, *supra* note 63, ¶ 125 (emphasis omitted)).
69. *Id.* ¶ 120.
70. *Id.* ¶ 124.

measure in question—the alcohol content level—was unrelated to the foreign or domestic origin of the product, albeit under a different part of Article III.[71] Obviously, this will be an area to watch in future GATT Article III cases, particularly in terms of how panels apply *DR – Cigarettes* to other fact situations.

Similarly, it is unfortunate that Honduras was not more explicit in its request for a panel regarding the different timing of payment of the Selective Consumption Tax amounts as between cigarette importers and domestic producers (or that the Panel and Appellate Body were not more flexible in treating those assertions as part of the GATT, Article III:4 claim). There is undoubtedly a significant economic difference between paying a tax immediately and receiving a grace period on the average of thirty-five days. Perhaps differing treatment is justified by the difficulties of collecting taxes from non-citizens, but that problem is presumably taken care of by applying the bonding requirement to importers.

One interesting aspect of the case is that it was brought by one small developing country WTO Member against another small developing country WTO Member. It is not unusual for developing country members to bring complaints against other developing countries; at least fifty-three such complaints have been filed since 1995, out of a total of about 335 through 2005.[72] However, the principal WTO developing country litigants tend to be the large ones, such as Brazil, India, Mexico, Turkey, etc. Presumably, that is in part because of the lack of experienced international trade litigators within trade ministries and/or the cost of retaining outside counsel. The Advisory Centre on WTO Law (ACWL) was established, according to its founders, to "level the playing field" for WTO litigation involving developing nations.[73] ACWL provides legal representation and assistance at fees substantially below those charged by private law firms. Interestingly, both the DR and Honduras are members of the ACWL. Since the organization could not represent both parties, it ultimately represented Honduras,[74] and the DR was forced to seek legal assistance elsewhere.[75]

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71. *See generally* Appellate Body Report, *Chile – Taxes on Alcoholic Beverages*, WT/DS87/AB/R, WT/DS110/AB/R (Dec. 13, 1999) (involving a Panel determination that Chile's differential treatment with regard to taxes on domestic as opposed to imported distilled spirits was inconsistent with Article III:2, which admittedly has different and perhaps narrower language, stating that "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.")

72. *See WTO Dispute* Update, *supra* note 20, at iv.

73. ACWL About Us, http://www.acwl.ch/e/about/about_e.aspx (last visited Apr. 15, 2005).

74. *See* ACWL Dispute Settlement, http://www.acwl.ch/e/dispute/dispute_e.aspx (listing this proceeding among those for which representation was provided).

75. ACWL referred the matter to a Washington, D.C., law firm, Sidley Austin. Email from an attorney at Sidley Austin, to David A. Gantz (Jan. 10, 2006) (on file with author).

Once the DSB adopted the reports, Honduras, in accordance with usual practice, requested a "reasonable period of time"[76] As the parties were unable to agree, an arbitrator was appointed,[77] but before his report was rendered the parties agreed on a reasonable amount of time, immediate elimination of the two percent tariff surcharge and the in-country affixing of the tax stamps, and twenty-four months for the foreign exchange fee.[78] The parties asked the arbitrator to issue his report nevertheless, which was done.

## B. Customs Classification, Tariff Bindings, and GATT Article II:1

### 1. Citation

*European Communities – Customs Classification of Frozen Boneless Chicken Cuts*, WT/DS269, 286/AB/R (issued September 12, 2005, adopted September 27, 2005) (complaints by Brazil and Thailand, with China and the United States as third parties).

### 2. Introduction and Explanation

#### a. "Simple" Classification or Something More?

On the surface, this appears to be a simple classification case (despite its 137 page length), that is, whether various EC measures relating to "classification of imported frozen and salted chicken cuts result in treatment for those chicken cuts that is less favourable than that provided for in the EC schedule."[79] However, it turned out to be considerably more complex than anyone anticipated. If less favorable treatment resulted, the EC would have been in violation of its "bound" tariff obligations under GATT Article II. Two tariff commitments are relevant: heading 02.10[80] concerns, "meat and edible meat offal, salted in brine, dried or

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76. DSU, art. 21.3(c).

77. *See WTO Dispute Update*, *supra* note 20, at 176; Report of Arbitrator, *Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes*, WT/DS302/17 (Aug. 29, 2005) [hereinafter *Cigarettes* Report of Arbitrator].

78. *Cigarettes* Report of Arbitrator, *supra* note 77, Annex I (letter to the arbitrator from the Honduran and Dominican Republic WTO ambassadors dated Aug. 16, 2005).

79. Appellate Body Report, *European Communities – Customs Classification of Frozen Boneless Chicken Cuts*, WT/DS269/AB/R, WT/DS286/AB/R, ¶142 (Sept. 12, 2005) [hereinafter *Chicken Cuts* Appellate Body Report].

80. The Harmonized System used in this database is an international commodity classification (six digit) developed under the auspices of the Customs Cooperation Council . . . . The Harmonized System nomenclature is logically structured by economic activity or component

smoked." Heading 02.07 concerns "meat and edible offal, of the poultry of heading No. 01.05, fresh, chilled or frozen." Heading 02.10, as enacted in the EU, carries a tariff of 15.4% *ad valorem*, while heading 02.07 carries a €102.4/100 kg tariff, which is the equivalent of fifty to sixty percent *ad valorem.*[81]

EC Regulation 535/94,[82] adopted in March 1994, amended an earlier regulation[83] to include a Note indicating that the term "salted" under the Note "means meat or edible meat offal which has been deeply and homogeneously impregnated with salt in all parts, having a total salt content no less than 1.2% by weight."[84] From 1996 to 2002, various European customs offices classified the products under dispute here—"frozen boneless chicken cuts impregnated with salt, with a salt content of 1.2%-3%"—as "salted" meat under heading 02.10 (and subject to the lower of the two duty rates).

However, the rules were changed in 2002. EC Regulation 1223/2002,[85] stipulated that boneless chicken cuts, which were slightly salted, with a salt content of 1.2% to 1.9%, were to be classified as "frozen" poultry meat under Heading 02.07, thus subject to the much higher duty rate. Decision 2003/97/EC[86] in 2003, implemented Regulation 1223/2002 (the so-called "subsequent measures") by directing Germany to change its "Binding Tariff Information"

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> material. For example, animals and animal products are found in one section; machinery and mechanical appliances which are grouped by function are found in another chapter . . . with the entire nomenclature being composed of [ninety-seven] Chapters . . . .

Harmonized System, Statistics Canda, March 14, 2005, http://www.statcan.ca/trade/htdocs/hsinfo.html. This case concerns Chapter 2 (two digits) "meat and edible meat offal" and two headings, 02.07, "meat and edible offal, of the poultry of heading 01.05, fresh, chilled or frozen" [heading 01.05 being live poultry] and heading 02.10, "Meat and edible meat offal, salted, in brine, dried or Smoked . . . ." Each chapter also has a series of "Notes" defining and/or limiting various headings. The Harmonized System (HS) and the Notes are essentially part of an international agreement to which all of the WTO Members are party, but the HS Convention is not one of the WTO agreements. There are also "Explanatory Notes" to add further explanation to the tariff classifications, but they are not mandatory.

81. Panel Report, *European Communities – Customs Classification of Frozen Boneless Chicken Cuts*, WT/DS269/R, WT/DS286/R, ¶ 7.3 (May 30, 2006) [hereinafter *Chicken Cuts* Panel Report].

82. Commission Regulation 535/94, 1994 O.J. (L 68) 15 (EC).

83. Council Regulation 2658/87, 1987 O.J. (L 256) 1.

84. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 142.

85. Commission Regulation 1223/2002, Concerning the Classification of Certain Goods in the Combined Nomenclature, and Corrigenda, 2002 O.J. (L179) 8, *available at* http://europa.eu.int/eur-lex/en/archive/2002/L-17920020709en.html.

86. Commission Decision of 31 January 2003, Concerning the Validity of Certain Binding Tariff Information (BTI) issued by the Federal Republic of Germany, 2003 O.J. (L 36) 40.

(BTI) (providing for classification under 02.10) so as to require the classification of the chicken parts with salt content from 1.9% to 3% under 02.07.[87] A further step was taken later in 2003, in EC Regulation 1871/2003, in which the term "salted" in heading 02.10 was defined to mean "meat and edible meat offal deeply and homogeneously impregnated with salt in all parts and having a total salt content of not less than 1.2% by weight, *provided it is the salting which ensures long-term preservation.*"[88]

The members of the Association of Poultry Processors and Poultry Trade in the EU countries (AVEC), finding it difficult to compete with imports from more efficient foreign producers that are not subject to the full range of EC health, animal welfare, and environmental restrictions, are obviously concerned about increasing imports and believe that it is "not in the interest of the [EU] consumers that the supply of poultry meat within the EU is highly dependent on imports."[89] AVEC alleged that the WTO action to require classification of chicken parts at the lower tariff level would result in the unemployment of 500,000 employees in the domestic poultry sector, and have adverse effects on the European wheat and corn producers who produce feed for chickens.[90] The EC presumably adopted these measures to prevent countries such as Brazil and Thailand (the major exporters) from continuing to export salted poultry cuts to Europe under the lower tariff rate. In support of its measures, the EC argued that lightly salted poultry meat should be classified under the heading 02.07 heading because it had to remain frozen for preservation, while the heading 02.10 heading was meant to apply to meat that was salted for the purpose of preservation.[91] By so acting in 2002 and 2003, the EC closed a loophole, under which Brazil and Thailand were exporting poultry cuts at the much lower customs tariff for heading 02.10. Not surprisingly, Brazil and Thailand alleged that through these regulatory changes, "the European Communities changed its customs classification so that those products, which had previously been classified under subheading 02.10.90.20 and were subject to an *ad valorem* tariff of 15.4%, are now classified under subheading 02.07.41.10 and are subject to a tariff of 102.4€/100kg/net . . . ."[92]

The poultry industry on the whole is potentially well-suited to world trade, as many developed countries' own production of poultry is declining as

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87. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 142.

88. *Id.* ¶ 143, (citing Article 1of EC Regulation 1871/2003 (emphasis added by the Appellate Body)).

89. *Position Paper on the New WTO Agreement*, Association of Poultry Processors (AVEC), Apr. 2005, at 2, *available at* http://www.avec.dk/sw4664.asp.

90. *See generally* U.S. DEPT. AGRIC., FOREIGN AGRIC. SERV., GAIN REP. NO. E35113, POULTRY AND PRODUCTS – WTO RULES AGAINST EU IN SALTED POULTRY CASE (Jun. 16, 2005) *available at* http://www.fas.usda.gov/gainfiles/200506/146130026.pdf#search='eu%20regulation%201223/2002'.

91. *Chicken Cuts* Panel Report, *supra* note 81, ¶ 7.81.

92. *Id.* ¶ 7.3.

more farmland is converted into housing and industrial development. Chicken is often cut into parts, packaged, and sold fresh or frozen, for export. In order to be considered "frozen," a chicken must be cooled to a temperature below 0° F. Frozen Boneless Chicken Cuts are pieces of white or dark meat that have the bone removed before freezing. The boneless chicken adds convenience to preparation and requires less effort when eating. Further, a frozen chicken may be safely prepared as long as a year after it was originally frozen.[93] Thailand and Brazil are the world's two largest exporters of this type of poultry product.

However, in the EU as in the United States, chicken farmers remain powerful constituencies that have been able to maintain protection for the products.[94] Poultry imports from Brazil and Thailand into the EU had soared through this "loophole" from 3000 MT in 1996 to 400,000 MT in 2001,[95] making this a significant issue for the EC's common agricultural policy. It was also a significant issue for Brazil and Thailand, since collectively their exports represented about eighty percent of total EU imports for the products in question.[96]

b. Issues and the Panel Decision Below

As the Appellate Body framed it,

> The ultimate question . . . is whether the measures at issue result in treatment of the products at issue [frozen boneless chicken cuts] . . . that is less favourable than that provided for under heading 02.10 of the EC [tariff] Schedule, because these measures subject the products at issue to duties that are in excess

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93. Hormel Foods, Chicken Handling, Safety and Storage, http://www.hormel.com/templates/knowledge/knowledge.asp?catitemid=24&id=149 (last visited Apr. 14, 2006).

94. In the United States, fresh, chilled or frozen chicken parts classified under subheading 02.07.13/14 carry a tariff of 17.64 cents per kilogram, while those salted, in brine, dried or smoked classified under subheading 02.10.99.20 carry a duty of 2.3% *ad valorem*. U.S. INT'L TRADE COMM'N, HARMONIZED TARIFF SCHEDULES OF THE UNITED STATES, 2-11 (2006) *available at* http://hotdocs.usitc.gov/docs/tata/hts/bychapter/0600C02.pdf (last visited Apr. 14, 2006). Assuming an FOB price of around $0.60 per pound, the duty on a pound of salted chicken parts would be about $0.014, while the per pound duty on the non-salted variety would be around $0.08.

95. *See generally* U.S. DEPT. AGRIC., FOREIGN AGRIC. SERV., GAIN REP. NO. E35113, POULTRY AND PRODUCTS – WTO RULES AGAINST EU IN SALTED POULTRY CASE (Jun. 16, 2005) *available at* http://www.fas.usda.gov/gainfiles/200506/146130026.pdf#search='eu%20regulation%201223/2002'.

96. *The Poultry Meat Sector in the European Union 2004*, ASSOCIATION OF POULTRY PROCESSORS (AVEC), at 11, 2004 *available at* http://www.avec.dk/sw291.asp.

> of those provided for in the EC Schedule and, potentially, to special safeguard measures. Resolving this question requires us to interpret heading 02.10 of the EC Schedule, which like all the Schedules of the Members . . . is an integral part of the *GATT* 1994 as well as of the *WTO Agreement*, by virtue of Article II:7 of the *GATT* 1994."[97]

The Appellate Body further observed that there was no disagreement among the parties that should the frozen boneless chicken cuts be covered by heading 02.07 of the EC Schedule, rather than heading 02.10, the tariff treatment accorded would be less favorable, and thus inconsistent with EC obligations under GATT Article II. In this determination, the crucial issue was the meaning of "salted."[98]

The Panel had relied for rules of interpretation on Articles 31 and 32 of the Vienna Convention on the Law of Treaties (VCLT or Vienna Convention),[99] beginning with an examination of the ordinary meaning of "salted," including its "factual context," and then proceeding to context; relevant subsequent practice; "objective and purpose" of the WTO Agreement and GATT 1994; and circumstances of conclusion of the WTO Agreement. The Panel concluded that the products were properly classified under heading 02.10, and that the EC's classification under heading 02.07 was less favorable than the treatment provided under the EC's tariff schedules.[100]

The Appellate Body divided its analysis into the following stages:

> (a) whether the two "subsequent" regulations (EC Reg. 1871 and 2344/2003), and products of a salt content in excess of [three percent], which had been excluded by the Panel, were properly within the Panel's terms of reference, as contended by Brazil and Thailand;
> (b) whether the Panel correctly interpreted the term "salted" in light of Article 31 of the Vienna Convention;
> (c) whether a requirement that "salted" in the context of heading 02.10 would undermine the object and purpose of security and predictability under the WTO Agreement and GATT 1994;
> (d) whether the Panel was correct in determining that the EC's practice between 1996 and 2002 of classifying frozen salted chicken parts under heading 20.10 constituted "subsequent practice" under VCLT, Article 31(3)(b); and

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97. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 145.
98. *Id.*
99. Vienna Convention on the Law of Treaties, May 23, 1969, 1155 U.N.T.S. 331, 8 I.L.M. 679 (1969).
100. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 147.

(e) whether the Panel correctly analyzed supplementary means of interpretation of heading 02.10 of the EC Schedule under VCLT, Article 32.

3. Holdings and Rationale

a. Terms of Reference[101]

There had been no disagreement that EC Regulation 1223/2002 and EC decision 2003/96/EC, as noted above, were the primary measures under challenge. They were the basis for reclassifying frozen boneless chicken with a salt content of 1.2%-1.9% under the higher tariff category, heading 02.07, and causing Germany to withdraw its binding tariff classification directing treatment under heading 02.10. However, the subsequent measures, which provided, *inter alia*, an additional note with the requirement that the salting "ensur[e] long-term preservation," were excluded from the case on the grounds that they had not been identified in Brazil and Thailand's panel requests. Drawing on Article 6.2 of the DSU, which provides in part that the panel request must "identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly," the Appellate Body upheld the Panel's action. In doing so, it distinguished *Chile – Price Band*,[102] which had allowed consideration of a subsequent law. The instant case, said the Appellate Body, was different, because the subsequent measures "make no reference to the original measures," have different legal implications, and are broader, covering all salted meat rather than just chicken.[103]

Also, the Panel effectively said that the dispute over the products at issue is not as based on the subsequent measures, that is, they are only frozen chicken cuts with a relatively low salt content of 1.2%-3%, not products that may have a greater salt content. If there is a challenge of classification decisions of customs authorities, as in *EC – Computer Equipment*, it may be appropriate to identify the products at issue to distinguish various contested measures. However, here, the contested measures are EC legal instruments, measures which define the products as frozen boneless chicken cuts with salt content of 1.2%-1.9% and 1.9%-3%. Since there are no meat products with a salt content of over three percent

101. *See id.* ¶¶ 149-169.

102. Appellate Body Report, *Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R (Sept. 23, 2002); *See* Raj Bhala & David A. Gantz, *WTO Case Review 2002*, 20 ARIZ. J. INT'L & COMP. L. 144, 221-57 (2003).

103. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶¶ 157-158.

identified in the panel request, the Appellate Body determined that the Panel acted properly in excluding them from the determination.[104]

b. Interpretation of the EC Schedule under VCLT, Article 31[105]

The Panel sought the "ordinary meaning" of "salted" through use of VCLT, Article 31(1), and decided to consider other relevant terms—"in brine," "dried," and "smoked"—as context under Article 31(2). For determining ordinary meaning, it first looked at dictionary definitions of "salted," and then proceeded to consider the "factual context" in terms that covered products, physical properties, and the concept of "preservation." The Panel viewed the "factual context" as demonstrating that the product (frozen chicken cuts) was altered through the addition of salt. The Panel concluded that "there is nothing in the range of meanings . . . of the term 'salted' that indicates that chicken to which salt has been added is not covered by . . . heading 02.10 of the EC Schedule."[106] It also found that the "ordinary meaning" was not dispositive.

The EC argued on appeal that an analysis of "ordinary meaning" under the VCLT does not contemplate analysis of "factual context" and that the latter is not relevant in determining the ordinary meaning of "salted." The Appellate Body began by reciting Article 31(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 objective and purpose." While there is no reference in this provision to "factual context," according to the Appellate Body, the Panel's consideration of the cited factors complemented its dictionary analysis and was thus appropriate. In any event, if the factors could not be properly considered as "ordinary meaning," they certainly could be considered as "context."

The EC had also argued that the Panel had effectively distorted the facts before it (relating to salt and preservation), leading to a violation of Article 11 of the DSU which requires "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." Not so, said the Appellate Body. The Panel's treatment of the facts, as in failing to distinguish between the salt content of the chicken parts *per se* and whether additional means of preservation are required, or realizing that salting did not preclude preservation by other means, did not reflect all of the EC's statements before it. However, the fact that the statements challenged by the EC were support for conclusions reached by the Panel based on separate considerations, and that the inaccuracies were

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104. *Id.* ¶¶ 167-169 (citing *Chicken Cuts* Panel Report, *supra* note 81, ¶ 7.37).

105. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶¶ 170-235, unless otherwise noted.

106. *Chicken Cuts* Panel Report, *supra* note 81, ¶ 7.15.

"inconsequential," convinced the Appellate Body that the Panel did not act inconsistently with DSU Article 11.[107]

With regard to "context," the Panel had reviewed "the terms of relevant aspects of the EC Schedule" such as the other terms in heading 02.10 and the structure of Chapter 2 of the EC schedule. The Panel considered the Harmonized System (HS) and the tariff schedules of other WTO Members, but concluded that this analysis of "context" did not indicate to the Panel that the "concession [in heading 02.10] is necessarily characterized by the notion of long-term preservation."[108] This was critical because of the EC's argument that for proper classification of frozen chicken cuts under heading 02.10, the salt had to be added as a means of long-term preservation. Thus, the use of the term "salt" indicated that the term "was characterized by the notion of long-term preservation." In opposition, Brazil and Thailand asserted that "salted" was really a term characterized by the concept of "preservation."[109]

The Vienna Convention, Articles 31(1) – (3) provide as follows:

> *General rule of interpretation*
>
> 1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty *in their context* and in the light of its object and purpose.
> 2. *The context* for the purpose of the interpretation of a treaty *shall comprise*, in addition to the text, including its preamble and annexes:
>
>> (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
>> (b) any instrument which was made by one or more parties in connection 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 (emphasis added).

107. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶¶ 182-186.
108. *Chicken Cuts* Panel Report, *supra* note 81, ¶ 7.245.
109. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 190.

The EU had contended that the HS was a relevant rule of international law; Brazil, that it constituted context under Article 31(2)(b); and Thailand, that the HS was context under Articles 31(1) or 31(3)(c). The United States, as a third party, suggested that the HS was a "supplementary means of interpretation" under VCLT, Article 32. The Panel, noting that it did not really matter which article was listed as the basis, decided to treat the HS as context under Article 31(2).[110] In support of its position, the Panel had noted that the HS membership is "extremely broad" and that it had been used as a basis for preparation of the Uruguay Round GATT tariff schedules.[111]

The Appellate Body observed that while the HS was not formally part of the WTO Agreement [not a "covered agreement" under DSU Article 1], the concept of "context" under VCLT, Article 31(2)(a) included "any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty." Various GATT decisions in 1983 and again in 1991 had been taken to implement the HS, and a number of WTO agreements use the HS for specific purposes. These links confirm that "there was broad consensus among the GATT Contracting Parties to *use* the Harmonized system as the basis of the WTO Schedules" and that this consensus "constitutes an 'agreement' between WTO Members 'relating to' the *WTO Agreement* that was 'made in connection with the conclusion of' that Agreement, within the meaning of Article 31(2)(a) of the *VCLT*."[112] As such, it is "context" according to the Appellate Body.

So, what is the meaning of the term "salted?" The Panel had looked at the other terms in heading 02.10, namely "in brine," "dried," and "smoked," without being able to identify a notion of either "preparation" or "preservation" in that heading. It found a similar lack of insight after reviewing the structure of Chapter 2 of the EC Schedule, or of other Member's tariff schedules. The EC contended, nevertheless, that the four processes, the three above and "salted" were always characterized by the notion of "preservation," while Brazil and Thailand contended that they were characterized only by the notion of "preparation."[113]

The Appellate Body noted the lack of "clear-cut definition[s]" of "preservation" or "preparation" or the differences between the two, observing that the EC had used both "preservation" and "long-term preservation," and had argued that "preparation" is "something lesser than preservation," that "preservation is . . . a kind of preparation" and that "preservation is for a much longer period, without offering a specific period of time."[114] Neither Brazil nor

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110. *Id.* ¶ 194.

111. *Chicken Cuts* Panel Report, *supra* note 81, ¶ 7.187.

112. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 199 (quoting Vienna Convention on the Law of Treaties, May 23, 1969, 1155 U.N.T.S. 331, 8 I.L.M. 679 (1969)).

113. *Id.* ¶¶ 201-202.

114. *Id.* ¶ 203 (citing the EC Appellant's submission, ¶¶ 82, 104, and EC statements at the hearing).

Thailand had offered a clear definition of "preservation," with Brazil conceding that there could be an overlap with "preparation" and Thailand asserting that the two concepts were mutually exclusive, at least for purposes of heading 02.10. Also, for the EC, meat is not "preserved" by adding salt unless the salt content is much higher than three percent. Brazil and Thailand contended that it is enough that meat be subjected to one of the four processes specified in heading 02.10, without preservation being a requirement.

As the Appellate Body defined it, the central question is thus whether the meat must have been preserved by salting or one of the other three processes in order to be properly classified under heading 02.10. For the Panel, the ordinary meaning of "salted" was that the product had been "altered," a conclusion that no party challenged. But must there be more? Is a product "salted" under heading 02.10 i) even if the process does not put the meat in a state of "preservation" or ii) does the salting have to be sufficient to place the meat in a state of "preservation?" The response to these questions requires a determination of whether "salted" in heading 02.10 means more than the ordinary meaning, as noted above.[115]

The Appellate Body's analysis began with an analysis of the other (beyond "salted") terms of heading 02.10. For the Appellate Body, the term "in brine" contemplates preservation, but it is not convinced that "dried, in brine and smoked" refer *exclusively* to preservation. Rather, "[t[he ordinary meanings of these terms suggest that the relevant processes can be applied to meat in various ways and degrees of intensity, thereby producing different effects on the meat, effects that may or may not place the meat in a state of 'preservation.'"[116]

Nor does the structure of Chapter 2, as the EC contends, support the conclusion that frozen chicken cuts are properly classified *exclusively* under heading 02.07. The Panel was not convinced that the scheme of Chapter 2—which the EU claims divides all covered products between those subjected to the four processes listed in heading 02.10 and those which are not, which fall within headings 02.01-02.08, noting also that heading 02.10 is the only one that does not refer to refrigeration—provided any real insights as to why Chapter 2 was structured in this manner.[117] The Appellate Body indicated that whether a product had been frozen would not determine whether it fell under heading 02.10, but rejected the EC's exclusivity argument. Rather, said the Appellate Body, the absence of a refrigeration requirement does not necessarily mean that the four heading 02.10 processes *necessarily* must place the meat in a state of preservation.

This view is supported by the Chapter and Explanatory Notes to the HS, which is also part of "context." The Panel did not find the Chapter or Explanatory Notes to be particularly helpful, because they did not clarify the ordinary meaning of "salted" or indicate whether the heading "was necessarily characterized by the notion of long-term preservation," and thus did not resolve the question of

115. *Id.* ¶¶ 208-209.
116. *Id.* ¶ 212.
117. *Id.* ¶¶ 214-217.

whether "preparation" and "preservation" were mutually exclusive in the context of heading 02.10.[118] The EC, Brazil, and Thailand all appealed this conclusion. The EC contended that the Panel had failed to consult the Explanatory Note, which it viewed as supporting its preservation argument, while Brazil and Thailand argued that the Explanatory Note and Chapter Note taken together support their view that preparation rather than preservation determines classification under heading 02.10. Even if the Panel confused the Explanatory Notes with the relevant Chapter Notes,[119] their overall analysis was correct. According to the Appellate Body, if a particular term is to control the definition of the scope of the heading, the HS uses those terms expressly. "Salted" when considered in context simply suggests "meat to which salt has been added." Thus, according to the Appellate Body, "heading 02.10 does not contain a *requirement* that salting must, by itself, ensure preservation,"[120] and the Panel was correct in determining that the EC's heading 02.10 concession is not necessarily characterized by "the notion of long-term preservation."[121]

At the same time, the HS does not "rule out the concept of 'preservation' under the term 'salted' in heading 02.10."[122] This in turn may require consideration of the General Rules of Interpretation; the Panel determined that because the products at issue are not *prima facie* classifiable under two headings [02.10 and 02.07] General Rule 3—designed to deal with such situations—was not applicable.[123] Brazil and Thailand appealed and asked that the Appellate Body complete the analysis and apply General Rule 3. However, according to the Appellate Body, General Rule 3 would apply only after there were a proper determination of the meaning and scope of heading 02.10.

#### c. Object and Purpose of the WTO Agreement and GATT 1994[124]

The Panel had found, *inter alia*, that the inclusion of a criterion of long-term preservation in the term "salted" in heading 02.10 "could undermine the object and purpose of security and predictability" underlying the WTO Agreement and GATT 1994.[125] The EC appealed, arguing that the Panel had failed to take into account the objective and purpose of Article II of the GATT as well as

118. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶¶ 220-222 (citing *Chicken Cuts* Panel Report, *supra* note 81, ¶ 7.223).

119. See *supra* note 80 for discussion of the differences between the two "Notes."

120. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶¶ 222-229.

121. *Id.* ¶ 235.

122. *Id.* ¶ 230.

123. *Chicken Cuts* Panel Report, *supra* note 81, ¶ 7.238.

124. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶¶ 236-250, unless otherwise noted.

125. *Chicken Cuts* Panel Report, *supra* note 81, ¶ 7.323.

heading 02.10 of the EC Schedule, the latter of which in the EC's view included the criterion of "long-term preservation," and reiterated its view that heading 02.10 did not address "frozen ["salted"] poultry." The Appellate Body asked, first, whether the Panel had erroneously distinguished between the objective and purpose of a treaty and the objective and purpose of its individual provisions. While the starting point may be the treaty in its entirety, taking into account individual terms is not excluded, particularly "if doing so assists the interpreter in determining the treaty's objective and purpose on the whole."[126] However, it would be inappropriate, according to the Appellate Body, to do so "in isolation from the objective and purpose of the treaty as a whole."

In particular, the Panel had concluded that "concessions made by WTO Members should be interpreted so as to further the general objective of the expansion of trade in goods and the substantial reduction of tariffs."[127] However, according to the Appellate Body—and contrary to what the EC had asserted—these objectives were not converted by the Panel into an interpretative principle, and the Panel was correct in treating the "security and predictability" of tariff concessions as an objective and purpose of both agreements.[128]

The EC also appealed the Panel's finding that the lack of certainty associated with the long-term preservation criterion would undermine the objective and purpose of security and predictability. Here, the argument was that the issue was not long-term preservation but, rather, that the EC measures treated chicken cuts with salt content up to three percent as falling under heading 02.07 rather than 02.10. The Appellate Body reiterated its view that the HS does not preclude the use of a preservation criterion, if it is a discernible characteristic.[129] However, the EC never explained what it meant by "long-term preservation," although it indicated that chicken cuts could be frozen and still classified under heading 02.10 as a "salted" product provided that the salting ensured preservation under the two EC measures. Nor did it explain how to distinguish, with regard to frozen and salted meat, the processes in headings 02.10 and 02.07, respectively. Given this lack of certainty, the Appellate Body upheld the Panel's finding.[130]

Nor was the Appellate Body sympathetic to the EC's argument that heading 02.10 was not intended to secure market access arrangements on frozen salted poultry meat. The Panel was correct and made no error in rejecting the EC's "unilateral object and purpose" because there was no indication in the Panel record "showing that it was a 'commonly shared view' of the parties to exclude frozen (salted) poultry meat from the product scope covered by heading 02.10 of the EC Schedule."[131]

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126. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 238.
127. *Chicken Cuts* Panel Report, *supra* note 81, ¶ 7.320.
128. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 243.
129. *Id.* ¶¶ 244-246, 230.
130. *Id.* ¶¶ 247-249.
131. *Id.* ¶ 250.

d. EC Classification Practice as Subsequent Practice[132]

Article 31(3) provides in pertinent part that: "There shall be taken into account, together with the context . . . (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation[.]" The Panel found that it was "reasonable to rely upon EC classification practice *alone* in determining whether or not there is 'subsequent practice' that 'establishes the agreement' of *WTO Members* with the meaning of Article 31(c)(b)."[133] Since the tariff schedules are unique to each Member, the Panel thought it was appropriate to rely on the EC's schedule. The Panel also reviewed the classification practices of Brazil and Thailand, and the third parties, China and the United States, but found this to be of "limited usefulness" at best.

The EC had appealed the Panel's finding that the EC's practice from 1996 to 2002 of classifying salted frozen chicken cuts under the lower tariff, heading 02.10, amounted to "subsequent practice" under VCLT, Article 31(3)(b). In particular, the EC argued that subsequent practice of a single party alone could not property determine the interpretation of a treaty. Brazil and Thailand countered that because it was the EC Schedule that was at issue, EC practice is very much relevant for the determination. The Appellate Body suggested that the issue raised three questions: i) what would qualify as practice; ii) how would the agreement of parties not engaged in the practice be established; and iii) were the practices of the EC and other WTO Members "consistent" under the VCLT provision?[134]

The Appellate Body began by noting the relatively high standard for a "practice," as established in *Japan – Alcoholic Beverages*, as a "'concordant, common and consistent' sequence of acts or pronouncements which is sufficient to establish a discernible pattern implying the agreement of the parties . . . ."[135] Does this mean that all WTO Members must have engaged in a particular practice for it to qualify as "subsequent practice?" The Panel said no; based on the language in an International Law Commission Report, it is not necessary that "every party must individually have engaged in the practice where it suffices that it should have accepted the practice."[136] However, the Appellate Body did not

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132. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶¶ 251-276, unless otherwise noted.

133. *Chicken Cuts* Panel Report, *supra* note 81, ¶¶ 7.253-.254.

134. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶¶ 253-254.

135. *Id.* ¶ 256 (quoting *Japan – Taxes on Alcoholic Beverages,* WT/DS8, 10, 11/AB/R, p. 13 (*adopted* Nov. 1, 1996)). According to the Appellate Body, this was further clarified in *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/AB285/AB/R, ¶ 192 (*adopted* Apr. 20, 2005) (reviewed elsewhere in this article).

136. *Chicken Cuts* Panel Report, *supra* note 81, ¶ 7.252 (quoting UNITED NATIONS INTERNATIONAL LAW COMMISSION, YEARBOOK OF THE INTERNATIONAL LAW COMMISSION VOL II. 222 (1966)).

fully agree. Each and every party to the treaty does not have to have engaged in the practice for it to qualify as subsequent practice. However, "practice by some, but *not all* parties is obviously not of the same order as practice by only one, or very few parties."[137] Of course, if only a few Members have engaged in the classification practice it reduces the availability of any "acts and pronouncements" that may be used to determine the existence of the practice.

Is the practice of one Member (the EC) sufficient? Not really. The headings 02.10 and 02.07 are hardly unique to the EC. During the Uruguay Round, tariff commitments were negotiated in accordance with the headings, structure, and descriptions of the HS, and many other Members included tariff bindings[138] for these two items, with similar if not identical listings. "The relevant headings are common to all WTO Members."[139] The EC schedule is therefore not unique, as Brazil and Thailand had argued, but may still be "relevant as evidence of what might have been agreed between WTO Members for the relevant tariff schedules."[140] When dealing with tariff commitments, "[t]he purpose of treaty interpretation is to establish the *common* intention of the parties to the treaty."[141] Therefore, in the Appellate Body's view, there cannot be "exclusive reliance on the importing Member's classification practice." Thus, the Panel erred in relying on EC practice alone as a basis for establishing "subsequent practice" under the WTO Agreement and GATT 1994, Article II.[142]

Should the Panel have reviewed subsequent practice for all salted products (as the EU argued), or only for salted chicken cuts (as Brazil and Thailand asserted)? According to the Appellate Body, what is relevant is the "classification practice relating to the entire range of salted meat products classifiable under 02.10 . . . ."[143] In this respect the Panel, which reviewed only salted chicken cuts, also erred.

If the practice of one Member is not sufficient, how does one know whether the other Members agree or disagree? The Panel concluded that it could be *presumed* that other WTO Members that did not "protest" the EC's classification practice during 1996 to 2002 accepted that practice.[144] The

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137. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 259.

138. A tariff is "bound" when the Member, in the course of tariff negotiations and in its WTO schedule, agrees that tariff on a particular item will not exceed a specific, negotiated level. RAJ BHALA, INTERNATIONAL TRADE LAW: THEORY AND PRACTICE 297 (2nd ed., Lexis 2000).

139. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 262.

140. *Id.* ¶ 264.

141. *Id.* ¶ 265 (quoting Appellate Body Report, *European Communities – Customs Classifications of Certain Computer Equipment*, WT/DS62/AB/R, WT/DS67/AB/R, WT/DS68/AB/R, ¶ 505 (June 5, 1998) [hereinafter *Computer Equipment* Appellate Body Report]).

142. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 266.

143. *Id.* ¶ 268.

144. *Chicken Cuts* Panel Report, *supra* note 81, ¶ 7.255.

Appellate Body, however, expressed "misgivings" about the Panel's deduction, and disagreed with the Panel's conclusion, largely because other Members may not have been aware of the EC practice. The fact that Brazil and Thailand accepted it "is not dispositive of whether other Members with actual or potential trade interests have also accepted that practice."[145] Also, while the Appellate Body rejected the EC's assertion that a practice in WTO context requires a two thirds vote under Article IX:2 of the WTO Agreement, it noted that in *Japan – Alcoholic Beverages* the Appellate Body cautioned against relying on "subsequent practice" to the point of interfering with the "exclusive authority" of the Ministerial Conference and the General Council to adopt binding interpretations of WTO agreements.[146] This means that the "lack of reaction" of other WTO members should "not lightly, without further inquiry . . . be read to imply agreement with an interpretation by treaty parties that have not themselves engaged in a particular practice followed by other parties in the application of the treaty."[147] The Panel thus erred again.

The final element of the Panel's analysis was its conclusion that evidence existed of a "consistent, common and discernible pattern" of classification of frozen boneless chicken parts under heading 02.10 during the 1996-2002 period.[148] This had been based on a review of classification practices of the EU; practices of Brazil, Thailand, China, and the United States were also considered by the Panel, but found by them to be of "limited probative value."[149] The Appellate Body chose not to examine this sub-issue, opining that even should it agree with the Panel, it would not affect the Appellate Body's conclusion, contrary to the Panel ruling, that the EC classification practice between 1996 and 2002 did amount to "subsequent practice" under the VCLT, Article 31(3)(b).[150]

#### e. Interpretation of the EC Schedule under VCLT, Article 32[151]

In seeking the proper meaning of the term "salted," the Panel had turned to supplemental means of interpretation under VCLT, Article 32, looking at "preparatory works" and then the "circumstances of conclusion of the EC [tariff] Schedule." It reviewed EC Regulation 535/94 and several European Court of Justice decisions.[152] The Panel further reviewed EC Explanatory Notes and an

145. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 273.
146. *Id.* ¶ 273 (citing *Japan – Alcoholic Beverages II*, p. 12).
147. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 273.
148. *Chicken Cuts* Panel Report, *supra* note 81, ¶¶ 7.265, .275.
149. *Id.* ¶¶ 7.284, .288-.289.
150. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶¶ 275-276.
151. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶¶ 277-346, unless otherwise noted.
152. *Chicken Cuts* Panel Report, *supra* note 81, ¶ 7.332; *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶¶ 277-278 (citing Case C-175/8, Dinter v. Hauptzollamt Köln-

additional Note as well as various classification practices, concluding that "meat that has been deeply and homogeneously impregnated with salt and has a minimum salt content of 1.2% by weight would qualify as 'salted' meat under the concession contained in heading 02.10 of the EC Schedule." This position was supported by Brazil and Thailand, as well as the United States, as third party; the United States also noted that EC Regulation 535/94 was issued prior to the verification of the EC's Uruguay Round Tariff schedules.[153] The Panel also considered as "'circumstances of conclusion' in this case the 'historical background compris[ing] the collection of events, acts and other instruments that characterize the prevailing situation in the European Communities' at the time the tariff commitment under heading 02.10 of the EC Schedule was negotiated."[154] On that basis, the Panel determined that these supplementary means of interpretation confirmed its analysis under VCLT, Article 31.[155]

The EC appealed, objecting to the Panel's use of VCLT, Article 32 and its interpretation of the ECJ's *Gausepohl* judgment, as well as its assessment of facts. Once again, the issue for the Appellate Body was whether the quantity of salt (1.2% here) was sufficient to ensure preservation, by itself. The Appellate Body saw the purpose of the analysis under VCLT, Article 32 as being to "ascertain whether WTO Members have agreed on the preservation criteria advanced by the EC . . . ."[156] As the Appellate Body noted, the means of interpretation set out in VCLT, Article 32 are supplemental means, to be used when "interpretation in the light of Article 31 leaves the meaning of treaty provisions ambiguous or obscure, or, in order to confirm the meaning resulting from the application of the interpretation methods listed in Article 31." Nor, it observed, does Article 32 "define exhaustively the supplemental means of interpretation to which an interpreter may have recourse."[157]

The EC had asserted that the concept of "circumstances" should be interpreted narrowly, and "a very high degree of consistency and strict conditions as to duration are required for prior practice to be established."[158] For the act or circumstances to qualify as "circumstances of the conclusion of the treaty," according to the EC, it must have influenced the common intentions of the parties during the drafting process.[159] The Appellate Body, however, believed that this standard was too strict. The event, act, or instrument may be a "circumstance" if it helps one to "discern the common intentions of the parties" at the time of the

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Deutz, 1983 E.C.R. 969; Case C-33/92, Gausepohl-Fleisch GmbH v. Oberfinanzdirektion Hamburg, 1993 E.C.R. I-3047).

153. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 136.

154. *Id.* ¶ 284 (quoting *Chicken Cuts* Panel Report, *supra* note 81, ¶ 7.340).

155. *Chicken Cuts* Panel Report, *supra* note 81, ¶ 7.423.

156. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 281.

157. *Id.* ¶¶ 282-283.

158. *Id.* ¶ 287.

159. *Id.* ¶ 288.

treaty's conclusion. Under these circumstances, "unilateral" acts as well as "multilateral" sources may also be useful for this purpose.[160]

The Appellate Body agreed with the Panel that relevance, not direct influence, is the proper criterion. For the Appellate Body, "the relevance of a circumstance for interpretation should be determined on the basis of objective factors, not subjective intent."[161] In terms of temporal correlation, the Panel decided that the period beginning before conclusion of the treaty until the actual conclusion was relevant, a position shared by the Appellate Body.[162]

In applying VCLT, Article 32, the Panel had decided (relying on the work of Sir Ian Sinclair) that constructive knowledge of a particular event, act or instrument by other negotiating parties was sufficient; the other parties did not have to have actual knowledge. The EC had objected to this approach, asserting that a relevant "circumstance" must be "evident to all negotiators at the time."[163] The Appellate Body agreed with the Panel, sort of. If the act or instrument was officially published, and thus made publicly available, it is sufficient to permit consideration as a circumstance under Article 32.[164] Moreover, the Appellate Body agreed with the Panel that it was within the Panel's discretion to examine not only the EC's classification practice, but the practices of other Members, and to determine which ones might not be relevant (that of the United States).[165]

The Panel had also addressed the various types of acts and instruments that could be considered as circumstances of conclusion and, in particular, whether classification practices, customs legislation, and court judgments could be relevant. The Panel had concluded over EC objections that EC classification practice subsequent to the conclusion of the WTO agreements could be taken into consideration under VCLT, Article 32 even if it did not qualify as "subsequent practice" under Article 31, relying on *EC – Computer Equipment.*[166] The Appellate Body agreed with the Panel, noting that "documents published, events occurring, or practice followed *subsequent to* the conclusion of the treaty may give an indication of what were, and what were not, the 'common intentions of the parties' *at the time* of the conclusion."[167] The relevance would have to be determined on a case-by-case basis. However, the Appellate Body in *EC – Computer Equipment* attached an important condition: "[in]consistent

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160. *Id.* ¶ 289.

161. *Id.* ¶ 291.

162. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 293.

163. *Id.* ¶¶ 294-295 (citing IAN SINCLAIR, THE *VCLT* ON THE LAW OF TREATIES 144, n. 36 (Manchester, 1984)).

164. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 297.

165. *Id.* ¶¶ 298-301.

166. *Id.* ¶¶ 302-304 (quoting *Computer Equipment* Appellate Body Report, *supra* note 141, ¶ 92).

167. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 305 (emphasis in Appellate Body Report).

classification practice *cannot* be relevant in interpreting the meaning of a tariff concession."[168]

With regard to legislation and court judgments, the Panel had concluded that both are relevant for purposes of interpretation, and the Appellate Body generally agreed, again relying on *EC – Computer Equipment.* However, the Appellate Body also cautioned that court judgments, because they deal with specific disputes, are by nature less relevant than "legislative acts of general application (although judgments may have some precedential effect in certain legal systems)."[169]

The EC, on appeal, argued that the Panel "mischaracterized the customs classification law and practice of the European Communities . . . and that this mischaracterization amounts to a distortion of facts contrary to [the 'objective assessment of the facts' obligation of] Article 11 of the DSU."[170] The Panel should have considered the "totality" of EC customs legislation, practice, and court judgments. In particular, the Panel erred when it determined that EC Regulation 535/94 "superseded" the ECJ judgment in *Gausepohl*, in that the criterion of preservation under heading 02.10 of the EC combined customs nomenclature no longer applied.[171] Brazil argued before the Appellate Body that EC Regulation 535/94 introduced an "objective criterion for the classification of salted meat (deep salt impregnation with a salt content of at least 1.2%), and did not refer to the concept of 'preservation,'" and otherwise defended the Panel's analysis.[172] Thailand argued that while in the earlier *Gausepohl* case it was determined that salting for the purpose of preservation (as well as specifying "deep and even impregnation and a salt content of at least 1.2% per weight"), was included, that criterion was omitted in EC Regulation 535/94 (although the other two were continued).[173] The EC disputed this, contending that the EC Regulation at best was only one part of the product description under heading 02.10, and did not alter the earlier requirement that salting ensure long-term preservation.[174]

After analyzing EC Regulation 535/94 in detail, the Appellate Body agreed that it was proper for the Panel to consider the Regulation as a "circumstance of conclusion" under VCLT, Article 32, even though it was unilateral in nature. As the Appellate Body noted, the Regulation "covers the same salted meat products that fall under the tariff commitment under heading 02.10 of the European Communities' WTO Schedule" and "there is no criterion of

168. *Id.* ¶ 307 (quoting *Computer Equipment* Appellate Body Report, *supra* note 141, ¶ 95) (emphasis in original).

169. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 309.

170. European Communities' Appellant's Submission at para. 311, *European Communities – Customs Classification of Frozen Boneless Chicken Cuts*, WT/DS269/AB/R, WT/DS286/AB/R (Sept. 12, 2005).

171. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 311.

172. *Id.* ¶ 312.

173. *Id.* ¶ 313.

174. *Id.* ¶ 323.

preservation or long term-preservation stated in the text of that Regulation."[175] Nor did the Appellate Body consider the ECJ court case, *Dinter*[176]—which had held that seasoned turkey meat should be classified in Chapter 16 rather than Chapter 2 of the EC schedule because Chapter 2 comprises meat that has undergone a preserving process—because it was old (decided in 1983).[177]

For the Panel, the 1993 *Gausepohl* case,[178] relied upon by Thailand as noted above, was considered more relevant. There, the ECJ clearly held that meat (of bovine animals) was properly classified as "salted meat only if it has been deeply and evenly impregnated with salt in all its parts for the purposes of long-term preservation so that it has a minimum total salt content of 1.2% by weight."[179] The Panel had, nevertheless, decided that to the extent *Gausepohl* was relevant, it had been superseded by EC Regulation 535/94. This conclusion was wrong, according to the EC, in part because a Commission Regulation cannot "override an interpretation given by the ECJ to the European Communities Combined Nomenclature, where that Nomenclature is implementing the Harmonized System . . . ."[180] For the Appellate Body, the fact that *Gausepohl* was issued at a time (May 1993) near the end of the Uruguay Round negotiations (December 1993), is not sufficient to conclude that the judgment "actually influenced or reflected, in substance, the common intentions of the negotiators with respect to heading 02.10 of the EC Schedule," particularly in light of the fact that the record before the Panel did not indicate that other WTO Members had actual knowledge of the *Gausepohl* decision.[181]

For the Appellate Body, the matter was further complicated by ambiguities in the *Gausepohl* decision. It was not clear to either the Panel or the Appellate Body whether for the ECJ meat deeply and homogeneously impregnated with a salt content of 1.2% is in itself sufficient to demonstrate preservation for the long-term, or whether 1.2% is the minimum level for meat which would qualify under 02.10 only if there is additional preservation for the long-term. In the absence of further information, the Appellate Body was not prepared to conclude that *Gausepohl* stands for the latter, minimum-level, approach.[182]

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175. *Id.* ¶¶ 322-323.

176. *See generally* Case C-175/8, Dinter v. Hauptzollamt Köln-Deutz, 1983 E.C.R. 969.

177. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 326.

178. *See generally* Case C-33/92, Gausepohl-Fleisch GmbH v. Oberfinanzdirektion Hamburg, 1993 E.C.R. I-3047.

179. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 328 (quoting Case C-33/92, Gausepohl-Fleisch GmbH v. Oberfinanzdirektion Hamburg, 1993 E.C.R. I-3047, ¶¶ 10-12, 16).

180. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶ 331.

181. *Id.* ¶¶ 333, 334.

182. *Id.* ¶¶ 335-336.

That decided, the Appellate Body turned to the question of whether post-WTO Agreement classification practice in the EC supports the EC position that "the criterion of 'preservation' governs its customs classification practice." The Appellate Body noted that EC Regulation 535/94 was determinative of classification practice in the critical 1996-2002 period.[183] As the Panel determined, during that period, some EC customs offices were classifying the products under heading 02.10, a number of BTIs to that effect had been issued, and three sets of minutes of European Communities' Customs Code Committee meetings also supported the heading 02.10 classification.[184] Trade data also confirmed that significant volumes of chicken cuts from Brazil and Thailand with a 1.2% salt content had been classified under heading 02.10 during that period, demonstrating again that no requirement of ensuring long-term preservation was being applied by European customs authorities during the period. Under these circumstances, the Appellate Body "fail[ed] to see how such a criterion could have entered into—even by implication—an agreement between the European Communities and other WTO Members with respect to the tariff commitment under heading 02.10 of the EC Schedule."[185] Moreover, the customs classification practice under heading 02.10 was continuous until EC Regulation 1223/2002, adding "provided . . . salting ensures long-term preservation" in 2002. Under these circumstances the Panel complied with its "objective assessment" responsibilities of DSU Article 11.[186]

In conclusion, the Appellate Body modified various aspects of the Panel's interpretation of VCLT, Article 32, found that the meaning of "salted" in the EC's heading 02.10 tariff commitment, as interpreted under Article 32, does not include a long-term preservation requirement, and upheld the Panel's conclusion that the supplementary interpretation it considered under Article 32 confirmed that the frozen chicken parts from Brazil and Thailand were properly covered by heading 02.10.[187]

### 4. Commentary

#### a. Customs Classification Issues are Important in the Real World

The case in the first instance is a highly technical analysis of a customs classification issue, but it is not as insignificant in the greater scheme of things as it first may appear. Although this was perhaps in substance just another instance

183. *Id.* ¶ 338.
184. *Id.* ¶¶ 338-341.
185. *Id.* ¶ 343.
186. *Chicken Cuts* Appellate Body Report, *supra* note 79, ¶¶ 344-345.
187. *Id.* ¶ 346.

of "garden variety" protectionism, where the EC acted to increase the duties on a sensitive product in response to demands from EC farmers, or equally common efforts by importers to find a lower tariff for their products through a "loophole," in terms of process it raised serious issues of tariff schedule interpretation and emphasized the enormous complexity of this process for customs officials, importers, exporters, and courts alike. And one should not underestimate the importance of "nitty-gritty" issues of tariff classification. It matters a great deal to poultry producers (and consumers) in the EC, Brazil, Thailand and elsewhere whether frozen chicken parts are subject to high or low tariffs, a factor among several that likely led to the decision of the (ACWL) to provide representation to Thailand in the dispute.

#### b. An Exhaustive Analysis of WTO Agreement and GATT 1994 Interpretation Techniques

With regard to issues of interpreting the WTO agreements, the Appellate Body discussed here, probably in greater detail than in any previous case,[188] the applicability of the VCLT on the Law of Treaties to such interpretation, what constitutes "subsequent practice" under Article 31 of the VCLT, and what domestic measures—customs classification decisions, legislation, court judgments—are relevant in determining the "circumstances of conclusion" of a treaty under VCLT, Article 32. The decision also addresses the question of the relationship of a non-"covered agreement"—the HS Convention[189]—to GATT, Article II, including the Chapter and the Explanatory Notes[190] to the HS and ultimately rejected the EC's implicit if not explicit statement that the HS Convention should trump the "covered agreements." This analysis of the VCLT, may be useful to other tribunals far afield from the WTO.

Under the circumstances, it is not surprising that the United States' third party submission generally supported the Appellate Body's analysis. The U.S. submission was more neutral than that of China's and discussed the issue of the treaty interpretation (in light of Articles 31 and 32 of the VCLT) and the proper approach for a Panel to municipal law, as well as to the issue of the proper classification for the poultry products in question.[191] The U.S. authorities likely

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188. With the possible exception of *Computer Equipment* Appellate Body Report, *supra* note 140, ¶ 92.

189. World Customs Organization, *International Convention on the Harmonized Commodity Description and Coding System* (June 14, 2003), *available at* http://www.wcoomd.org/ie/en/topics_issues/harmonizedsystem/hsconve2.html.

190. *See supra* note 80 for a description of the Notes.

191. United States' Third Participant Submission, *European Communities – Customs Classification of Frozen Boneless Chicken Cuts*, WT/DS269/AB/R, WT/DS286/AB/R, ¶¶ 14-17 (Sept. 12, 2005), *discussed in Chicken Cuts* Appellate Body Report, *supra* note 79, ¶¶ 139-140.

saw this case as an opportunity to offer to and receive important guidance from the Appellate Body concerning the proper interpretation of the WTO Agreements and the GATT 1994.

c. Impact on the United States

With respect to direct effects on the United States, it is the U.S.' export industry in this area—the world's second largest chicken exporter after Brazil[192]—that will more likely be affected than the import market. U.S. exports of chicken to the EC's $1.2 billion market have been minimal since 1997, when the EC banned the use of anti-microbial treatments for sanitizing poultry carcasses, effectively halting U.S. exports.[193] If Brazil and Thailand (and other exporting countries) are again allowed to export large quantities of poultry cuts to the EC under the customs heading 02.10 (which will likely happen once the decision is implemented either in the form of a new EC Directive or Regulation), the EC will once again be bracing itself for a flood of lower-priced imports of frozen boneless poultry meat from Brazil and Thailand (the main producers) as well as from other countries such as Bulgaria and Chile.[194] This result is, of course, better than the alternatives; had the EC been allowed to restrict its market to imports from Brazil and Thailand, that production might have been diverted elsewhere, in more direct competition with U.S. chicken exports to third countries. Of course, concerns over avian flu may also disrupt the EC and other major markets, at least for Asian suppliers such as Thailand. Uncooked chicken parts from Thailand have been banned from the EC since 2004—during much of the time required for this case to proceed through the panel and Appellate Body process—and this ban may well continue indefinitely.[195]

Since the parties were apparently unable to agree on a reasonable period of time for the EC to implement the decision of the DSB, Brazil requested binding arbitration under DSU Article 21.3(c) on November 22, 2005.[196] In his ruling, the arbitrator (James Bacchus, a former Appellate Body member and chairperson) determined that the "reasonable period of time" for EC implementation is nine

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192. For calendar 2006, Brazil was expected to export 3040 thousand metric tons, with the U.S. at 2538 thousand metric tons. U.S. DEPT. OF AGRIC., FOREIGN AGRIC. SERV., LIVESTOCK AND POULTRY: WORLD MARKETS AND TRADE 24 (Nov. 2005).

193. U.S. DEPT. AGRIC., FOREIGN AGRIC. SERV., GAIN REP. NO. 35166, TRADE POLICY MONITORING – ANALYSIS OF US POULTRY MEAT TRADE WITH THE EU: PAST, PRESENT AND FUTURE 3 (Aug. 25, 2005).

194. *Id.* at 14.

195. *See EU Bans Chicken Imports from Thailand*, UK, FOOD STANDARDS AGENCY, Jan. 23, 2004, *available at* http://www.food.gov.uk/news/newsarchive/2004/jan/avainflu (reporting on an EU ban on raw chicken imports from Thailand as a result of avian flu concerns).

196. *WTO Dispute Update*, *supra* note 20, at 179.

months from the date of adoption of the Panel and Appellate Body reports (September 27, 2005), or by June 27, 2006.[197] In the decision, the arbitrator took into account that because of the challenged EC measures Brazilian chicken exports were €300 million lower than would otherwise have been the case,[198] as well as the various procedural steps, as the Commission will be required to enact a Regulation that puts the EC in compliance with the WTO decision.[199]

## II. TRADE REMEDIES

### A. Anti-Dumping and Countervailing Duties and Sunset Reviews

#### 1. Citation

*United States – Anti-Dumping Measures on Oil Country Tubular Goods (OCTG) from Mexico*, WT/DS282/AB/R (issued November 2, 2005, adopted November 28, 2005) (complaint by Mexico, with Argentina, Canada, China, Chinese Taipei, EC, Japan as third parties).

#### 2. Introduction and Explanation

##### a. What are OCTG?

OCTG are used in the oil and gas industry and include goods such as steel tubes and drill pipes used in oil and gas exploration and transportation. OCTG are hollow steel products of circular cross-section, including oil well casing, tubing, and drill pipe, or iron (other than cast iron) or steel (both carbon and alloy), whether seamless or welded, whether or not conforming to American Petroleum Institute (API) or non-API specifications, whether finished or unfinished (including green tubes and limited service OCTG products).[200] OCTG consists of circular pipes of carbon or alloy steel and seamless or welded

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197. Award of the Arbitrator, *European Communities – Customs Classification of Frozen Boneless Chicken Cuts*, WT/DS269/13, WT/DS286/15, ¶ 84 (Feb. 20, 2006).

198. *Id.* ¶ 31.

199. *Id.* ¶¶ 69, 70, 72, 73, 75, 77, 78. *See also* Daniel Pruzin, *EU Directed by Arbitrator to Meet WTO Chicken Customs Ruling by June 27*, 23 INT'L TRADE REP. (BNA) 727 (Feb. 23, 2006) (noting the result and observing that the arbitrator had rejected the EC's assertion that it would be required to obtain a ruling from the World Customs Organization before the Regulation could be implemented).

200. *See* Oil Country Tubular Goods (OCTG) from Argentina, Austria, Italy, Japan, Korea, Mexico, and Spain, 60 Fed. Reg. 40,855 (Aug. 10, 1995) [hereinafter OCTG from Argentina].

construction that can be plain end, threaded at one or both ends, or threaded and coupled.

b. Sunset Reviews

The Sunset Review mechanism provides one of the two principal mechanisms for parties seeking relief from anti-dumping orders (the other being the "changed circumstances" review under which petitioners have historically rarely prevailed).[201] Under the WTO's AD Agreement, WTO members must terminate anti-dumping duty orders no later than five years from the date of imposition "unless the authorities determine, in a review initiated before that date . . . that the expiry of the duty would likely lead to a continuation or recurrence" of dumping and injury.[202] The U.S. Anti-Dumping Law reflects the sunset provisions of the AD Agreement. U.S. sunset review procedures are established under the U.S. anti-dumping laws,[203] the Procedures for Conducting Five-year (Sunset) Reviews of Antidumping and Countervailing Duty Orders, also known as the U.S. Department of Commerce (USDOC) Regulations,[204] the Sunset Policy Bulletin (SPB),[205] and to a more limited extent, the Statement of Administrative Action (SAA).[206]

The U.S. sunset review mandates that the government consider terminating an outstanding order after five years, a process in which both Commerce and the USITC may participate, with the USDOC review focused on the likelihood of continued dumping, and the USITC review focused on the likelihood of injury should the dumping order be revoked. These automatic reviews of dumping and countervailing orders or suspension agreements initiated by the Department of Commerce incorporate detailed procedures to assure all interested parties a chance to participate.[207]

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201. Under U.S. law, changed circumstances reviews are provided for under Sections 751 and 752(c) of the U.S. Tariff Act of 1930, 19 U.S.C. §§ 1675(b), 1675a(a), 1675a(c) (2000).

202. Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, annex 1A, art. VI, Apr. 15, 1994, 33 I.L.M. 1125 (1994).

203. 19 U.S.C. §§ 1675(c), 1675a(a), 1675a(c).

204. 19 C.F.R. §§ 351.218 (2005).

205. Policies Regarding the Conduct of Five-Year (Sunset) Reviews of Antidumping and Countervailing Duty Orders; Policy Bulletin, 63 Fed. Reg. 18,871-01 (Apr. 16, 1998).

206. STATEMENT OF ADMINISTRATIVE ACTION TO THE URUGUAY ROUND AGREEMENTS ACT, H.R. DOC. NO. 103-316 (1994), *reprinted in* 1994 U.S.C.C.A.N. 4040. The SAA is a document prepared by the U.S. Government that is submitted to Congress along with trade agreements to explain the draft legislation proposed for implementation of the trade agreement under U.S. law.

207. *Id.* *See also* 19 U.S.C. § 1675(c) (2000), *amended by* Uruguay Round Agreements Act, Pub. L. No. 103-465 (providing the statutory basis for sunset reviews).

In a sunset review by the USITC—the focus of this case—the USITC is required to determine whether revocation or termination of an order is "likely to lead to continuation or recurrence of material injury within a reasonable foreseeable time," leaving it broad discretion in predicting the future ("the determination called for . . . is inherently predictive and speculative").[208] Among the substantive factors to be considered by the U.S. administrative authorities in such proceedings are the likelihood of material injury caused by the affected imports in the future—based on import volume and trends—and the likelihood of dumped or subsidized imports continuing in the absence of a dumping order.[209] These sunset requirements have, in practice, made it much more difficult for foreign parties to obtain termination of orders, except where the domestic industry does not object. With respect to the steel industry the U.S. sunset review process has resulted in WTO litigation at both the Panel and eventually the Appellate Body level in this case and in two others.[210]

### c. The Proceedings Before the Investigating Authority

Following the USITC's finding that U.S. producers of OCTG were being materially injured by competition from dumped imports,[211] the USDOC imposed anti-dumping orders on OCTG from these countries. According to the USITC, "OCTG are hollow steel products of circular cross-section." These products include oil well casing, tubing, and drill pipe, of iron (other than cast iron) or steel (both carbon and alloy), whether or not conforming to API or non-API specifications, whether finished or unfinished (including green tubes and limited service OCTG products).[212]

Five years later, pursuant to statute,[213] the USITC instituted a sunset review to determine whether revocation of the antidumping orders would likely lead to the recurrence of material injury to U.S. OCTG producers within a reasonably foreseeable period of time. The USITC cumulated the volume and effect of imported OCTG from the seven reviewed countries. The USITC then

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208. Statement of Administrative Action, Pub. L. No. 103-465, 1994 U.S.C.C.A.N. (108 Stat.) 4208.

209. 19 U.S.C. § 1675(c)(1).

210. Appellate Body Report, *United States – Sunset Reviews of Antidumping Measures of Oil Country Tubular Goods from Argentina*, WT/DS268/AB/R (Nov. 29, 2004) [hereinafter *OCTG Argentina* Appellate Body Report]; Appellate Body Report, *United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan*, WT/DS244/AB/R (Dec. 15, 2003) [hereinafter *Corrosion-Resistant Steel Sunset Review* Appellate Body Report]; S*ee* Raj Bhala & David A. Gantz, *WTO Case Review 2004*, 22 ARIZONA J. INT'L & COMP. L. 99, 219-32, 249 (2005).

211. *See* OCTG from Argentina, *supra* note 200.

212. *Id.* at n.2.

213. 19 U.S.C. § 1675(c).

found that, in the event of revocation of the anti-dumping order, these cumulated imports would likely cause recurrence of material injury to U.S. OCTG producers within a reasonably foreseeable time.[214]

#### d. The Panel Decision and Appeal

The WTO dispute panel found in favor of Mexico on two of its complaints lodged against the U.S. sunset and administrative reviews that led to the continued levying of anti-dumping duties on imports of OCTG manufactured by Mexican producers. The panel agreed with Mexico that the USDOC examination in the reviews of the likelihood of continued or recurring dumping was not carried out in accordance with the WTO's AD Agreement. The panel also found the Commerce Department's SPB setting forth procedures on the conduct of sunset was not WTO consistent.[215] However, the panel rejected several Mexican claims, among them that the Commerce Department's decision not to revoke the 21.7% duties in its fourth administrative review of the duty order was inconsistent with the ADA. It also rejected Mexico's claim that USITC's conduct of its review on whether the lifting of the duties would lead to continued injury for competing U.S. OCTG producers was inconsistent with the AD Agreement.[216]

Both the United States and Mexico subsequently appealed the Panel Decision. In its appeal, the United States argued that the panel's conclusion was based on erroneous findings on issues of law and related interpretations. It argued, *inter alia*, that the panel failed to apply the correct burden of proof in evaluating whether Mexico made a prima facie case with respect to the Sunset Policy Bulletin. The United States said the panel also "misapplied" the Appellate Body's analysis in an earlier WTO challenge filed by Argentina in the U.S. duty order on its OCTG exports and erroneously concluded that Mexico had made a prima facie case. It further argued that the panel also failed to apply the correct standard in evaluating whether the Sunset Policy Bulletin is inconsistent with Article 11.3 of the AD Agreement.[217]

However the United States did not appeal the panel's finding in favor of Mexico that USDOC's likelihood-of-dumping determination in the sunset review was inconsistent with Article 11.3 of the AD Agreement, because the determination that dumping was likely to continue or recur was not supported by

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214. Oil Country Tubular Goods from Argentina, Italy, Japan, Korea and Mexico, Invs. Nos. 701-TA-364 (Review) and 731-TA-711, 713, 716 (Review), 66 Fed. Reg. 35997-01 (Jul. 10, 2001).

215. Appellate Body Report, *U.S. – Anti-dumping Measures on Oil Country Tubular Goods (OCTG) from Mexico*, WT/DS282/AB/R, ¶ 4 (Nov. 2, 2005) [hereinafter *OCTG Sunset Review* Appellate Body Report].

216. *Id.*

217. *Id.* ¶¶ 63-77.

reasonable and adequate fact based conclusions.[218] As a result, the panel's findings on that point still stood. Compliance was required by the United States, and the United States and Mexico agreed in February 2006 that such compliance would occur by May 28, 2006.[219]

e. The Issues on Appeal[220]

As framed by the Appellate Body, the principal issues on appeal were the following:

> (a) whether a causal link must be established between dumping and likelihood of injury in a sunset review determination under Article 11.3 of the Antidumping Agreement (governing sunset reviews), as required in investigations in Article 3.5 (governing injury determinations);
> (b) whether the USITC's decision to cumulate imports from various OCTG exporters in making the likelihood-of-injury determination was consistent with Articles 3.3 and 11.5 of the Antidumping Agreement;
> (c) whether the likelihood-of-dumping determinations by the USDOC, and the reliance on that dumping margin determination by the USITC, were inconsistent with Articles 2 (governing dumping margin determinations) and 11.5 of the Antidumping Agreement;
> (d) whether the Panel acted inconsistently with the "objective assessment" requirements of the DSU Article 11 in refusing to find that the United States lacked the legal basis to continue the AD duties on OCTG beyond the five year period established in Article 11.3 of the Antidumping Agreement;
> (e) whether, with regard to the USDOC's "Sunset Policy Bulletin" (SPB), the Panel failed to make an "objective assessment" as required by DSU Article 11 of its consistency with Article 11.3 of the Antidumping Agreement, and in finding that relevant provisions of the SPB are inconsistent with Article 11.3; and

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218. *See* Panel Report, *U.S. – Anti-dumping Measures on Oil Country Tubular Goods (OCTG) from Mexico*, WT/DS282/R, ¶ 7.80 (June 20, 2005) [hereinafter *OCTG Sunset Review* Panel Report].

219. Daniel Pruzin, *U.S., Mexico Set Deadline for Compliance with WTO Oil Country Tubular Goods Ruling*, 23 INT'L TRADE REP. (BNA) 288 (Feb. 23, 2006).

220. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 102.

> (f) whether, if the Appellate Body reverses the Panel in (e), above, the various U.S. laws, regulations, Statement of Administrative Action and USDOC administration of them are accomplished in a uniform, impartial and reasonable manner in accordance with Article X of GATT 1994.

3. Holdings and Rationale

a. Causation Standards in Sunset Reviews[221]

Here, Mexico had argued that Article 3 should have been applied by the Panel in the likelihood-of-injury determination under Article 11.3, but the Panel found that "the obligations set out in Article 3 are not directly applicable in sunset reviews."[222] Mexico was implicitly criticized for not explaining to the Panel why Article 11.1 of the AD Agreement and Article VI of GATT establish "inherent" causation requirements, parallel but independent to those in Article 3.5, and that failure was the basis of the Panel's decision not to address the argument further.[223] The United States disagreed with the "inherent" causation approach, reminding the Appellate Body that in the past the Appellate Body had determined that sunset reviews are separate and distinct from initial investigations, and that there could be no "automatic importation" of the requirements of the latter into the former.[224]

On its face, Article 11.3 of the AD Agreement does not require investigating authorities to establish the existence of a "causal link" between likely dumping and likely injury. Instead, by its terms, Article 11.3 requires investigating authorities to determine whether the *expiry of the duty* would be likely to lead to *continuation or recurrence of dumping and injury*. Thus, in order to continue the duty, there must be a nexus between the "expiry of the duty," and the "continuation or recurrence of dumping and injury," such that the former "would be likely to lead to" the latter. In this respect, it must be noted that under Article 11.3 of the AD Agreement, the termination of the anti-dumping duty at the end of five years is the rule and its continuation beyond that period is the "exception."[225] The use of the word "likely" in Article 11.3 shows that "an affirmative likelihood determination may be made only if the evidence demonstrates that dumping [and injury] would be probable if the duty were

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221. *Id.* ¶¶ 103-136.

222. *OCTG Sunset Review* Panel Report, *supra* note 218, ¶ 7.117.

223. *Id.* ¶ 6.12.

224. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 106 (citing U.S.'s Appellee's Submission, *U.S. – Anti-dumping Measures on Oil Country Tubular Goods (OCTG) from Mexico*, WT/DS282/AB/R, ¶ 311 (Nov. 2, 2005) [hereinafter U.S.'s Appellee's Submission]).

225. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 108.

terminated—and not simply if the evidence suggests that such a result might be possible or plausible."[226]

According to the Appellate Body, however, this "silence [in Article 11.3] does not exclude the possibility that the requirement was intended to be included by implication."[227] The Appellate Body began by examining Article VI of the GATT 1994, as the AD Agreement implements that provision in respect of anti-dumping measures. It found that Article VI establishes the fundamental principle that there must be a causal link between dumping and injury to a domestic industry if an anti-dumping duty is to be levied on a dumped product. It further establishes that the purpose of an anti-dumping duty is to counteract dumping that causes injury and that several provisions of the AD Agreement confirm and reinforce this fundamental principle including Article 3, entitled "Determination of Injury" and Article 5, which deals with "Initiation and Subsequent Investigation."[228]

The Appellate Body then examined the provisions of the AD Agreement that dealt with the "review" of anti-dumping duties levied after an original investigation. It found that Article 11.1 of the AD Agreement establishes an overarching principle for "duration" and "review" of anti-dumping duties in force.[229] It provides that "an anti-dumping duty shall remain in force only as long as and to the extent necessary to counteract dumping which is causing injury." This principle applies during the entire life of an anti-dumping duty. If, at any point in time, it is demonstrated that no injury is being caused to the domestic industry by the dumped imports, the rationale for the continuation of the duty would cease. In its interpretation of Article 11.1 the Appellate Body relied on the Appellate Body Report in *US – Corrosion-Resistant Carbon Steel*. Although the Appellate Body's reasoning in that case related to the interpretation of Article 21.1 of the SCM Agreement, the Appellate Body considered that it applied, *mutatis mutandis*, to the interpretation of Article 11.1 of the AD Agreement, given that these provisions are almost identical.[230]

For the Appellate Body, the fact that a causal link between dumping and injury is essential to Article VI and the AD Agreement "does not mean that a causal link . . . must be established anew in the 'review' conducted under Article 11.3 of the Antidumping Agreement. This is because the 'review' contemplated in Article 11.3 is a 'distinct' process with a 'different' purpose than the original

226. *Corrosion-Resistant Steel Sunset Review* Appellate Body Report, *supra* note 210, ¶ 111.

227. *Id.* ¶ 109 (citing Appellate Body Report, *United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany*, WT/DS213/AB/R, ¶ 65 (Nov. 28, 2002)).

228. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶¶ 111-113.

229. *Id.* ¶ 116 (citing *Carbon Steel* Appellate Body Report, *supra* note 63, ¶ 70).

230. *Id.* ¶ 115.

investigation."[231] Quoting further from *OCTG Argentina*, the Appellate Body here emphasized the distinction, with "Article 11.3 requir[ing] an investigating authority, in order to *maintain* an anti-dumping duty, to review an anti-dumping order that has already been established—following the prerequisite determinations of dumping and injury—so as to determine whether the order should be continued or revoked."[232] For Article 11.3 reviews, therefore, "it is reasonable to assume that, where dumping and injury continues or recurs, the causal link between dumping and injury, established in the original investigation, *would exist and need not be established anew*."[233]

This conclusion is reinforced by the fact that, in the Appellate Body's view, various circumstances may exist at the time of a sunset review. Dumping may have continued during the period of the order with the domestic industry not having recovered; dumping may have continued, with recovery of the domestic industry, but with a risk of further injury if the order is revoked. Or it may have ceased and the industry recovered, but further evidence may be needed to determine if the revocation of the order would lead to recurring imports, dumping and injury. Various factors, such as the magnitude of dumping, price effects, the extent of recovery, import and domestic market shares, may also be relevant.[234] For the Appellate Body, the "essential element" for an affirmative determination under Article 11.3 is "proof of likelihood of continuation or recurrence of dumping and injury, if the duty expires." The required evidence depends on the facts, and a determination must rest on a "sufficient factual basis" permitting the investigating authority "reasoned and adequate conclusions." But there is no requirement of establishing a causal link between likely dumping and likely injury flows, and "adding such a requirement would have the effect of converting the sunset review into an original investigation, which cannot be justified."[235]

What then is the relationship between the USDOC's likelihood-finding and that of the USITC? Is Mexico correct in asserting that if the USDOC finding is WTO-inconsistent that necessarily renders the USITC finding WTO-inconsistent as well? No. Mexico offers no "textual support," and its position is not legally tenable. The two inquiries are "separate, regardless of whether they are carried out by the same or different authorities in a Member's administrative system." One is not automatically dependent on the other unless the likelihood-of-injury determination rests on a likelihood-of-dumping determination that is later found to be flawed.[236]

231. *Id.* ¶ 118 (citing *OCTG Argentina* Appellate Body Report, *supra* note 210, ¶ 359).

232. *Id.* ¶ 120 (citing *OCTG Argentina* Appellate Body Report, *supra* note 210, ¶¶ 328, 359).

233. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 121 (emphasis added).

234. *Id.* ¶ 122.

235. *Id.* ¶ 123.

236. *Id.* ¶¶ 126-127.

Predictably, Mexico charged that the Panel's dismissal of its "inherent" causation argument on grounds that Mexico failed to make its case constituted a failure by the Panel to conduct an "objective assessment" under DSU Article 11. No, said the United States; a violation of Article 11 in this case requires a showing by Mexico "that the Panel's findings that Mexico had failed to substantiate its assertions was in error and prevented the Panel from making an objective assessment of the matter."[237] The Appellate Body essentially agreed with the United States, seeing assertions, but "no explanation or elaboration by Mexico that the causal link must be established in a sunset review irrespective of the applicability of Article 3.5 [of the Antidumping Agreement]."[238]

Also, the Appellate Body reminds the parties that, as it said in *DR – Cigarettes*,[239] "there is no obligation upon a panel to consider each and every argument put forward by the parties in support of their respective cases, so long as it completes an objective assessment of the matter before it, in accordance with Article 11 of the *DSU*." What the panel must do in this case, as stated by the Appellate Body in *EC – Poultry*, is to "reasonably consider Mexico's claim" but the Panel is not obligated to address specifically its findings on "inherent" causation.[240]

### b. Cumulation in Sunset Reviews[241]

In its determination of likelihood-of-injury, the USITC had found that revocation of outstanding anti-dumping orders against Argentina, Italy, Japan, South Korea, and Mexico would likely lead to a continuation of dumping. Mexico challenged the decision of the USITC to consider the imports of these five nations in the aggregate, or to cumulate. The Panel noted that Article 11.3 of the AD Agreement failed to mention cumulation, and that the Agreement provided "no direct guidance in this matter."[242] Following the Appellate Body Report in *OCTG Sunset Review*, the Panel determined that "the silence of the AD Agreement on the question of cumulation in sunset reviews is properly understood to mean that cumulation is permitted in sunset reviews" and that Article 3.3 of the

237. *Id.* ¶¶ 131-132, (citing Mex.'s Appellant's Submission, *U.S. – Anti-dumping Measures on Oil Country Tubular Goods (OCTG) from Mexico*, WT/DS282/AB/R, ¶ 67 (Nov. 2, 2005) [hereinafter Mex.'s Appellant's Submission] and U.S.'s Appellee's Submission, *supra* note 224, ¶ 8).

238. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 133.

239. *See* discussion *supra* Part II.I.A.

240. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶¶ 134-135 (citing *European Communities – Measures Affecting Certain Poultry Products*, WT/DS69/AB/R, ¶ 135 (Jul. 13, 1998)).

241. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶¶ 137-173.

242. *OCTG Sunset Review* Panel Report, *supra* note 218, ¶ 7.147.

AD Agreement (establishing the conditions for cumulation) applies "*only* in original antidumping investigations."[243]

Mexico again challenged the Panel under DSU Article 11 for disregarding various arguments made by Mexico. In fact, the Panel had implicitly criticized Mexico for "failing to explain or elaborate on its bare assertion that Article 11.3 [of the Antidumping Agreement] somehow establishes 'inherent' obligations for cumulation independent of those in Article 3.3." Under such conditions the Panel "did not consider it necessary to address this aspect of Mexico's argument."[244] The Appellate Body sided with the Panel and the United States on appeal and dismissed Mexico's assertion under DSU Article 11.

Based on essentially the same assertions, Mexico also contended that the Panel had misinterpreted Article 11.3 of the AD Agreement with regard to cumulation, "simply assuming" that because Article 3.3 was not applicable to sunset reviews, cumulation by the USITC could not be inconsistent with Article 11.3. The Appellate Body disagreed, effectively praising the Panel for its analysis (as summarized above). The Appellate Body also accepted the Panel's statement that, "[e]ven assuming Mexico were correct in asserting that the objective and purpose of Article 11.3 is to 'ensure that anti-dumping measures would not continue in perpetuity,' a cumulative analysis does not vitiate that objective and purpose."[245]

Mexico had further argued that the USITC was effectively required to make a "threshold finding" that the affected imports "would be simultaneously present in the U.S. market" as a precondition to cumulating, and that the Panel had erred in failing to address this issue. The United States pointed out that Mexico failed to indicate where it had requested such a finding and that, in any event, the Panel had [correctly] determined that the AD Agreement "simply does not prescribe a methodology for cumulation in sunset reviews."[246]

Here again, the Appellate Body had little sympathy for Mexico's position, noting the lack of any textual support in the AD Agreement for its views on the requirement of a threshold finding; no such finding is even required in Article 3.3, which governs cumulating in investigations. It reiterated its finding in *US – Corrosion-Resistant Steel Sunset Review* that "Article 11.3 does not expressly prescribe any specific methodology for investigating authorities to use in a sunset review."[247] While "an examination of whether imports are in the

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243. *Id.* ¶¶ 7.148, 7.150 (citing *OCTG Argentina* Appellate Body Report, *supra* note 210, ¶ 295) (emphasis in original).

244. *OCTG Sunset Review* Panel Report, *supra* note 218, ¶ 6.19.

245. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 146 (quoting *OCTG Sunset Review* Panel Report, *supra* note 218, ¶ 7.149).

246. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶¶ 148-149, (quoting Mex.'s Appellant's Submission, *supra* note 237, ¶ 77 and U.S.'s Appellee's Submission, *supra* note 224, ¶ 57).

247. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 151 (quoting *Corrosion-Resistant Steel Sunset Review* Appellate Body Report, *supra* note 210, ¶ 123).

market together and competing against each other may, in certain cases, be needed in a likelihood-of-injury determination where an investigating authority chooses to cumulate the imports from several countries," that requirement "flows from the particular facts and circumstances of a given case" rather than from any requirement under Article 11.3.[248]

Another aspect of Mexico's challenge was the assertion that the factual record before the USITC failed to show "positive evidence demonstrating that imports from Mexico, Argentina, Italy, Korea and Japan would be present in the United States market at the same time . . . if the order were revoked."[249] It is not sufficient that imports from the various countries were present in the U.S. market at the time of the original investigation. The United States argues, logically enough, "[i]f imports were simultaneously present before the order and imports were simultaneously present after the order, it is unclear how Mexico arrives at the conclusion that imports would *not* be present simultaneously if the order were revoked."[250]

The USITC had, in fact, analyzed four factors relevant to cumulation: i) whether the imports from any of the countries were likely to have an effect on the domestic industry; ii) whether the imports and domestic products were fungible; iii) whether the imports and domestic products would be sold in the same distribution channels; and iv) whether the imports and domestic product would be present in the same geographic markets at the same time if the order were revoked.[251] For the Appellate Body, it was reasonable, once the USITC collected this information, to rely on it in deciding whether cumulation was appropriate, and in predicting future market conditions. Contrary to what Mexico has charged, the information collected by the USITC (the "evidentiary basis") supported a "prospective analysis based on inferences drawn from the evidence on the record."[252]

But, Mexico argued, relying on *OCTG Argentina*, that the USITC failed to apply the legal standard required by Article 11.3 where it assessed the likelihood of simultaneity of the presence of imports from multiple countries, as that approach was based on a determination by the USITC that there was no evidence in the record showing that the imports and domestic like product would *not* be simultaneously present.[253] The United States argued that it was proper for the USITC, after determining simultaneity before and after the order, to conclude that it would continue in the event the order were revoked.[254]

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248. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 153.
249. Mex.'s Appellant's Submission, *supra* note 237, ¶ 86.
250. U.S.'s Appellee's Submission, *supra* note 224, ¶ 27.
251. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 156.
252. *Id.* ¶¶ 158-159.
253. Mex.'s Appellant's Submission, *supra* note 237, ¶¶ 93-94.
254. U.S.'s Appellee's Submission, *supra* note 224, ¶ 60 (citing *OCTG Argentina* Appellate Body Report, *supra* note 210, ¶ 323).

For the Appellate Body, Mexico had "misunderstood" the earlier decision. There, the Appellate Body found that "the likely standard of Article 11.3 applies to the overall determinations regarding dumping and injury" and that "it need not necessarily apply to each factor considered in rendering the overall determinations on dumping and injury."[255] However, even if this were applicable to the USITC's likelihood of simultaneity analysis, the Appellate Body disagreed with Mexico that the USITC's standard conflicted with Article 11.3, "[b]y requiring a demonstration that the imports 'would not' be simultaneously on the market."[256] Also, the USITC had more than a "mere absence of contradictory information" to rely on, i.e., data on current market conditions (fungibility, channels of distribution, and simultaneous presence) and the inferences it drew from that data.[257]

Did the USITC's likelihood-of-injury determination violate Article 11.3 of the AD Agreement, as Mexico contended, because it failed to identify the time frame within which the imports would be simultaneously present in the U.S. market and the resulting injury? Again the Appellate Body said no. If there is a sufficient factual basis for the likelihood-of-injury determination, the lack of a specified time frame does not undermine the determination.[258]

Mexico's third anti-cumulation argument is that once the USITC decided to cumulate Mexican source imports with those of the other four countries under Article 11.3 of the AD Agreement, the USITC was required to do so consistently with Article 3.3, regardless of whether that article explicitly applied to sunset reviews.[259] This contention is based on an analogy drawn to the Appellate Body report in *US – Corrosion-Resistant Steel Sunset Review*, in which it was decided that if the investigating authority relies on dumping margins in making likelihood-of-dumping determinations in sunset reviews, the calculation of margins must be consistent with Article 2.4 of the AD Agreement (governing margin calculations in investigations).[260] The United States countered with a reference to *OCTG Argentina*, for the proposition that Article 3.3 does not apply to sunset reviews; if this were the case, then neither do Article 3.3's conditions.[261]

The Appellate Body agreed with the United States, and its interpretation of *OCTG Argentina*, noting as well, it had stated in that case Article 3.3 applies to a situation "[w]here imports of a product from more than one country are

255. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 163 (quoting *OCTG Argentina* Appellate Body Report, *supra* note 210, ¶ 323).

256. Mex.'s Appellant's Submission, *supra* note 237, ¶ 94.

257. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 164.

258. *Id.* ¶ 166.

259. Mex.'s Appellant's Submission, *supra* note 237, ¶ 103.

260. *Id.* (citing *Corrosion-Resistant Steel Sunset Review* Appellate Body Report, *supra* note 210, ¶ 127).

261. U.S.'s Appellee's Submission, *supra* note 224, ¶ 22 (citing *OCTG Argentina* Appellate Body Report, *supra* note 210, ¶ 301).

simultaneously subject *to anti-dumping investigations*,"[262] and reiterating its earlier observation that "original investigations and sunset reviews are distinct processes with different purposes. The disciplines applicable to original investigations cannot, therefore, be automatically imported into review processes."[263] Again, to the extent a cumulation analysis is required for a sunset review under Article 11.3, that requirement "derived from the obligations under Article 11.3 itself, and not from the conditions specified in Article 3.3"[264] The Panel's conclusion that the USITC's decision to "conduct a cumulative assessment of imports in making its likelihood of injury determination" was not in violation of Article 11.3 was thus upheld by the Appellate Body.[265]

c. Margins of Dumping in Sunset Reviews[266]

The Panel had declined, over Mexico's objection, in the interest of judicial economy, to adjudicate Mexico's claim that the USDOC's likelihood-of-dumping analysis was inconsistent with Article 2 of the AD Agreement, given that it had found that the determination was inconsistent with Article 11.3. In part, this was because the USDOC had relied on import volumes rather than on historical dumping margins, and in reliance on the Appellate Body Report in *US – Corrosion-Resistant Steel Sunset Review*, where it was stated that "should investigating authorities choose to rely upon dumping margins in making their likelihood determination, the calculation of these margins must conform to the disciplines of Article 2.4." (The USDOC did not so rely in the present case.)[267]

The Appellate Body found Mexico's arguments unpersuasive, given the lack of explanation as to why resolution of the Article 2 issue was necessary to resolve the dispute. Moreover, the Mexican argument was based on a faulty assumption, that the United States "used" a dumping margin in this particular sunset review. While the USDOC calculated such dumping margins for *OCTG*, it relied only on import volumes in making its likelihood determination, and the Panel made a factual finding to that effect, a finding with which the Appellate

262. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 170 (quoting *OCTG Argentina* Appellate Body Report, *supra* note 210, ¶ 294) (emphasis added by Appellate Body in this case).

263. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 170 (citing *Corrosion-Resistant Steel Sunset Review* Appellate Body Report, *supra* note 210, ¶¶ 106-107 and *Carbon Steel* Appellate Body Report, *supra* note 63, ¶ 87).

264. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 171.

265. *Id.* ¶ 173.

266. *Id.* ¶¶ 174-182, unless otherwise noted.

267. *Id.* ¶¶ 174-175 (citing *OCTG Sunset Review* Panel Report, *supra* note 218, ¶¶ 7.80-.82 (quoting *Corrosion-Resistant Steel Sunset Review* Appellate Body Report, *supra* note 210, ¶ 127)).

Body found no reason to interfere.[268] The *US – Corrosion-Resistant Steel Sunset Review* proposition is thus inapplicable, and the Panel's use of judicial economy is affirmed.[269]

d. Legal Basis for Continuing Anti-Dumping Duties[270]

The original request for a panel alleged that the determination of both the USDOC (in determining the likelihood of continued dumping should the anti-dumping order be rescinded) and the USITC (in determining the likelihood of injury in case of rescission) were inconsistent with Article VI of GATT and with Article 11.3 of the AD Agreement.[271] However, the United States did not appeal the Panel's finding that the USDOC had acted inconsistently with Article 11.3. As a result, Mexico had requested the Panel to find that the United States lacked any legal basis to continue imposing anti-dumping measures after five years, and renewed that request before the Appellate Body.[272] Mexico asserted that once a Member is found to have acted inconsistently with Article 11.3, the Member has no choice other than to terminate the Antidumping Duty immediately. The Member does not have the alternative of undertaking a new sunset review, because of the five year time limit on continuation of anti-dumping duties imposed by Article 11.3.[273]

The Appellate Body declined, on the ground that making or not making this additional finding was within the discretion of the Panel. According to the Appellate Body, Mexico was correct in its analysis of the Article 11.3 requirement for termination after five years, except when the order is continued based on a valid sunset review. However, the USDOC's action inconsistent with Article 11.3 "does not necessarily imply that the underlying anti-dumping duties must be terminated immediately." As the Appellate Body observed, other provisions of the DSU [Article 21] govern implementation of the recommendations and rulings of the DSB, and those provide, *inter alia*, "the means of implementation and the reasonable period of time accorded to the implementing Member for implementation"[274]

The Appellate Body also distinguished *EC – Sugar*,[275] on which Mexico had relied. That case involved a dispute regarding the obligation of panels to

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268. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶¶ 179-180.

269. *Id.* ¶¶ 181-182.

270. *Id.* ¶¶ 183-190, unless otherwise noted.

271. *Id.* ¶ 3.

272. *Id.* ¶ 183.

273. *Id.* ¶ 185.

274. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 187.

275. Appellate Body Report, *European Communities – Export Subsidies on Sugar*, WT/DS265/AB/R, WT/DS266/AB/R, WT/DS283/AB/R (Apr. 28, 2005) (reviewed *infra* Part III.B) [hereinafter *Sugar Export Subsidies* Appellate Body Report].

make a recommendation under Article 4.7 of the SCM Agreement[276] with regard to the time period for withdrawal of subsidies held to be inconsistent with Article 3 of the SCM Agreement. Moreover, the Panel's error there was failing to rule on a claim before it. Also, as the Appellate Body observed, there is no parallel provision in the AD Agreement. Mexico did not rely on DSU, Article 19.1, second sentence, which permits but does not oblige panels to make suggestions.[277] Accordingly, the Panel complied with its obligations under DSU Article 11 by declining to make a specific finding regarding the United States' legal basis to continue the anti-dumping duties in force.[278]

e. Consistency of the Sunset Policy Bulletin "As Such"[279]

Challenges to the U.S. SPB, a manual setting out guidelines for the conduct of sunset reviews that is neither a law nor regulation, have occurred before, in at least three earlier cases, *US – Carbon Steel*, *US – Corrosion-Resistant Steel Sunset Review*, and *OCTG Sunset Review*.[280] Here, the United States challenged that the Panel failed to apply the proper standard in determining whether the SPB was consistent with Article 11.3 of the AD Agreement and, thus, with the "objective assessment requirements" of DSU Article 11.[281] The United States believed that the Panel, although it analyzed the SPB consistently with earlier Appellate Body decisions, should have stressed whether the "probative value of other factors might have outweighed that of the factual scenarios in section II.A.3" and whether the SPB effectively required USDOC to reach the determinations it made in individual cases.[282]

The challenged section II.A.3 of the Policy Bulletin reads in pertinent part as follows:

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276. Agreement on Subsidies and Countervailing Measures [hereinafter SCM Agreement], Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Subsidies and Countervailing Measures, annex 1A, Apr. 15, 1994, 33 I.L.M. 1125 (1994).

277. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 189. Article 19.1 provides in pertinent part that the panel and Appellate Body "*may* suggest ways in which the Member concerned could implement the recommendations." *Id.* (emphasis added).

278. *Id.* ¶ 190.

279. *Id.* ¶¶ 191-211, unless otherwise noted.

280. *See, e.g.*, Raj Bhala & David A. Gantz, *WTO Case Review 2004*, 22 ARIZONA J. INT'L & COMP. L. 222-32, 242-46 (2005) (discussing *Corrosion-Resistant Steel Sunset Review* Appellate Body Report, *supra* note 210 and *OCTG Argentina* Appellate Body Report, *supra* note 210).

281. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 191.

282. *Id.* ¶ 193.

II. Sunset Reviews in Antidumping Proceedings

A. *Determination of Likelihood of Continuation or Recurrence of Dumping*

. . .

3. Likelihood of Continuation or Recurrence of Dumping

. . .

[T]he Department normally will determine that revocation of an antidumping order or termination of a suspended dumping investigation is likely to lead to continuation or recurrence of dumping where—

(a) dumping continued at any level above *de minimis* after the issuance of the order or the suspension agreement, as applicable;

(b) imports of the subject merchandise ceased after issuance of the order or the suspension agreement, as applicable; or

(c) dumping was eliminated after the issuance of the order or the suspension agreement, as applicable, and import volumes for the subject merchandise declined significantly.

The Department recognizes that, in the context of a sunset review of a suspended investigation, the data relevant to the criteria under paragraphs (a) through (c), above, may not be conclusive with respect to likelihood. Therefore, the Department may be more likely to entertain good cause arguments under paragraph II.C in a sunset review of a suspended investigation.[283]

283. The Panel noted that "Mexico does not challenge the 'good cause' aspects of US law." *OCTG Sunset Review* Panel Report, *supra* note 218, ¶ 7.34 n.48 (confirmed by Mexico in response to questioning at the oral hearing). *See also OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 194 n.297.

The Panel took the position that under Article 11.3 of the AD Agreement, the likelihood-of-injury determination had to rest on a sufficient factual basis, based on presumptions:

> that establish a priori conclusions in certain factual situation[s] *without the possibility of consideration of all the facts and circumstances* . . . . [I]f certain evidentiary factors are treated as determinative or conclusive, we would conclude that they create an *irrebuttable presumption*, and thus that the relevant provisions are inconsistent with Article 11.3 of the AD Agreement.[284]

The Panel further emphasized that its review could not be based simply on statistics to determine whether "the scenarios in the SPB are consistently treated by the USDOC as determinative or conclusive . . . ." The Panel further noted that this issue is not consistency in outcomes, but consistency in decision-making. As in past cases, "[t]he fact that in each of 232 of the sunset review determinations put before us in evidence, USDOC made an affirmative determination of likelihood of continuation or recurrence of dumping is not sufficient in itself to demonstrate that the scenarios set out in the SPB are determinative or conclusive."[285]

For Mexico, the United States' complaints about the panel related to factual determinations not subject to appeal. However, the Appellate Body disagreed, noting that the relevant portions of the Panel Report involved a "legal characterization of facts."[286] Initially, the Appellate Body emphasized that the issue is whether the factual scenarios outlined in the SPB are "determinative/conclusive" and "mechanically applied" by the USDOC. Other factors must not be excluded.[287] Also, the Appellate Body noted that there could be variations under the three factual scenarios in the SPB; the "nature and extent of evidence required for an objective determination and who bears the onus of introducing the evidence" will be determined whether this situation is one of *continuation* of dumping after the order or a *recurrence* of dumping.[288] Under the circumstances, the USDOC must not apply the three criteria "mechanistically" but must "seek out information on relevant factors and evaluate their probative value." However, the responding parties "do have a responsibility to submit information

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284. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 192 (quoting *OCTG Sunset Review* Panel Report, *supra* note 218, ¶ 7.27 (emphasis added by Appellate Body)).

285. *OCTG Sunset Review* Panel Report, *supra* note 218, ¶¶ 7.49-.51.

286. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 195.

287. *Id.* ¶ 196.

288. *Id.* ¶ 197.

and evidence in their favour, particularly about the pricing behaviour, import volumes and dumping margins."[289]

The Panel had reviewed 232 USDOC likelihood-of-dumping determinations (all of which had resulted in likelihood findings) and concluded that the "USDOC has consistently based its determinations in sunset reviews exclusively on the scenarios, to the disregard of other factors"[290] in finding a violation of Article 11.3 of the AD Agreement. However, in the Appellate Body's view the Panel's analysis was flawed. Of the 232 determinations, 206 were "expedited" reviews in which the foreign respondents did not participate at all, or did not participate fully. The sampling examined by the Panel indicated that all were based on one of the three SPB scenarios. Most damning, the Panel simply speculated that there might have been other relevant or probative facts, but these were not before the Panel and thus were not addressed. This record, said the Appellate Body, does not "reveal whether the USDOC excluded or disregarded evidence or factors that might have outweighed the probative value of the factual scenarios of the SPB," and it may be that in some of the sampled cases the dumping had continued for the life of the order or for a substantial period after the order was issued. "We simply do not know."[291]

As the Appellate Body recounted, the Panel examined the other twenty-one affirmative determinations (excluding five relating to suspended investigations). In fifteen of those, the USDOC appeared (to the Panel) to have concluded that dumping had continued after the imposition of the order, above a *de minimis* level (i.e., under scenario (a) of the SPB). In seven, there was no *appearance* of other arguments put forward by the respondents regarding other factors, while such arguments *appeared* to have been made in five. In the remaining three cases, the respondents' arguments supporting good cause to consider other arguments were rejected by the USDOC, but the Panel did not analyze the USDOC's reasoning, based on the specific facts. Thus, according to the Appellate Body (as also noted by the Panel), "the significance for its analysis of the determinations of the USDOC lies not in the results, but whether the USDOC is required to make an affirmative determination when one of the factual scenarios is present."[292]

For the Appellate Body, the Panel simply did not conduct an adequate review, one that might "reveal that the affirmative determinations . . . were based *exclusively on the scenarios to the disregard of other factors.*" Nor does the Panel's review of these cases "reveal that the USDOC's affirmative determinations were based solely on the SPB scenarios . . . ." The Panel thus failed to conduct a "qualitative assessment" of the USDOC's determination such

289. *Id.* ¶ 201.
290. *OCTG Sunset Review* Panel Report, *supra* note 218, ¶ 7.63.
291. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶ 203.
292. *Id.* ¶¶ 204-206 (emphasis in Appellate Body Report).

as would permit it to "properly conclude that the SPB requires the USDOC to treat factual scenarios . . . of the SPB as determinative or conclusive."[293]

Thus, the panel had "failed to make an objective assessment of the matter" by not demonstrating that the Commerce Department's determinations in the reviews were based solely on the factual scenarios set out in Section II.A.3, and in disregarding other evidence presented by Commerce to refute this claim, and is reversed. In consequence, the Panel's finding that Mexico established a *prima facie* case of the inconsistency of the SPB with Article 11.3 of the AD Agreement, which requires a determination that dumping is likely to continue or recur is founded on "reasoned and adequate conclusions based on the facts before it," is rendered moot.[294] Further, because the Appellate Body reversed the Panel's finding that the SPB was inconsistent with Article 11.3, it also summarily rejected Mexico's assertions that the U.S. Tariff Act of 1930, the Statement of Administrative Action, and the SPB "collectively and independently" establish a standard that is inconsistent with Article 11.3.[295]

f. Article X:3 of the GATT; Transparency Issues[296]

Mexico also argued, independently of its challenges based on the AD Agreement, that certain evidence presented by Mexico to the Panel demonstrates "a clear and undeniable pattern of biased and unreasonable decision making by the [USDOC] in its administration of the laws, regulations, decisions and rulings pertaining to sunset reviews."[297] However, the Panel did not consider Mexico's claim.

Article X:3 of GATT 1994 provides that: "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." (Paragraph 1 refers to "[l]aws, regulations, judicial decisions and administrative rulings of general application, made effective by any Member."). The Appellate Body noted that an inquiry under Article X:3 "entails an inquiry much different from that involved in determining whether the SPB instructs the USDOC to treat certain scenarios as conclusive or determinative contrary to Article 11.3 of the *Antidumping Agreement*." Accordingly, it declined to pursue such an inquiry because the Panel had not considered it earlier.[298]

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293. *Id.* ¶ 209.
294. *Id.* ¶¶ 210-211.
295. *Id.* ¶¶ 213-214.
296. *Id.* ¶¶ 215-218, unless otherwise noted.
297. Mex.'s Appellant's Submission, *supra* note 237, ¶ 172.
298. *OCTG Sunset Review* Appellate Body Report, *supra* note 215, ¶¶ 217-218.

4. Commentary

a. USDOC and the Sunset Policy Bulletin

In *US – Corrosion-Resistant Steel Sunset Review*, the Appellate Body largely approved the methodology of the U.S. Department of Commerce in its conduct of likelihood-of-the-continuation-of-dumping aspect of sunset reviews, even in a situation where of 227 reviews undertaken, *no* anti-dumping duty had been revoked.[299] Here, the Appellate Body followed the same approach, despite similar statistics. It again overturned the Panel's finding that Section II.A.3 of the U.S. SPB, which sets out procedures on the conduct of sunset reviews, is inconsistent with the AD Agreement because it limits consideration of individual cases to the factual scenarios set out in the SPB. If anything, the affirmation of the Appellate Body of the basic framework of the SPB is stronger than in earlier cases. It is possible that in some future case one or more Members will provide a much more detailed analysis of USDOC practice under Section II.A.3 of the SPB, an analysis that demonstrates that the USDOC in fact ignores other relevant factual information, and treats the SPB as conclusive, such that the Panel's fact findings and reasons satisfy the Appellate Body, but that has not happened yet.

In terms of the system, is this result good or bad? It depends. In the authors' view, the existence of the Sunset Policy Bulletin is a positive factor, as it increases the transparency of the USDOC process beyond the level which would exist if interested parties presenting their cases to the USDOC were required to rely on the statute and regulations alone. On the other hand, Section II.A.3 of the SPB does appear to establish a relatively rigid framework. Clearly, suspicions that those standards are applied mechanically, without any real analysis, will persist so long as all or essentially all USDOC likelihood reviews result in positive determinations.

In addition, the Appellate Body implicitly affirmed the USDOC's practice of utilizing dumping margins from the investigation and administrative reviews (rather than calculating new ones as part of the sunset review). If the USDOC calculated new margins, those calculations would have to be consistent with Article 2, notwithstanding the fact that the sunset review was taking place under Article 11.3. However, there is still no requirement to calculate anew as part of a sunset review.

b. USITC, Causation, Cumulation and Article 11.3 of the AD Agreement

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299. *See* Raj Bhala & David A. Gantz, *WTO Case Review 2004*, 22 ARIZ. J. INT'L & COMP. L. 99, 228-32 (2005) (discussing the USDOC's sunset review methodology and the Appellate Body's analysis of it).

Contrary to Mexico's claim, the Appellate Body determined that the USITC was not obliged to establish anew a causal link between likely dumping and likely injury in the sunset review, which it had already done in the original investigation. More generally, the Appellate Body—wisely in the authors' view—has confirmed, on the basis of a close textual analysis of Article 11.3 of the AD Agreement, that the provisions of the AD Agreement that are applicable to investigations are not necessarily applicable to the conduct of sunset reviews. Thus, the investigating authority retains significant discretion regarding its conduct of the likelihood-of-injury aspect, reiterating its approach in *OCTG*. This affirmation of flexibility relates not only to causation and cumulation, addressed in this case, but presumably to other aspects of sunset reviews on which Article 11.3 is silent, but are explicitly dealt with in other AD Agreement provisions. Perhaps this result also reflects, at least indirectly, what would be obvious to any Panel or Appellate Body member from the record before it: in terms of the thoroughness of sunset reviews in the United States, the USITC likelihood-of-injury determination is a far more extensive and analytical process, with determinations based on the fact of the individual case, than the USDOC's likelihood-of-the-continuing-of-dumping analysis.

The Appellate Body's approach, particularly with regard to cumulation, has left the sunset review process subject to some ambiguity, as to which aspects, if any, of AD Agreement requirements for investigations are also applicable to sunset reviews. Article 11.3 does not preclude cumulation in sunset reviews even when the key elements of cumulation under Article 3.3 (for investigations) are not fully met. Yet, said the Appellate Body, market analysis of imports from different nations (and, presumably, other normal considerations for cumulation) may be required "under the particular facts and circumstances of a given case." (As the above discussion notes, in this particular case the USITC actually did conduct a detailed and apparently thorough cumulation analysis.) More elucidation would be helpful from the Appellate Body. It is not difficult to postulate situations in which cumulation was fully justified during the original investigation, but may be questionable after five years if the mix of covered products or relative volumes have significantly changed.

In any event, investigating authorities would be wise to follow the lead of the USITC in the thoroughness with which they address the cumulation (and other) issues relating to likelihood-of-injury, although that will not necessarily preclude the Appellate Body from incorporating in Article 11.3 other requirements of provisions of the AD Agreement that by their terms apply only to investigations, not to sunset reviews "under the particular facts and circumstances of a given case."

Notwithstanding its general success at the Appellate Body, the United States did not appeal the Panel's ruling that the USDOC review of the likelihood of continued or recurring dumping was inconsistent with the requirements of

Article 11.3, in that U.S. law (not the SPB) established an irrebuttable presumption that dumping is likely to continue or recur if the order is rescinded.[300]

## **B. Countervailing Duties and Subsidies**

### 1. Citation

*United States – Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors (DRAMS) from Korea*, WT/DS296/AB/R (issued June 27, 2005, adopted July 20, 2005) (complaint by Korea, with China, Chinese Taipei, EC, Japan as third parties).

### 2. Introduction and Explanation

#### a. The Case Below

This controversy began in November 2002, when the USDOC initiated a countervailing duty investigation on the petition of Micron Technology, Inc., against two giant Korean semiconductor manufacturers, Hynix Semiconductor, Inc. (formerly Hyundai) and Samsung Electronics, Inc.[301] In its final subsidy determination of June 2003, USDOC found that Hynix had received countervailable financial contributions, not directly from the Korean Government (Korea), but through Korea's "entrustment" and "direction" of Hynix' creditors, both public and private, so that Hynix' financial viability could be maintained.[302] The USDOC divided the various creditors into three groups, A (public bodies), B (owned and controlled by the government), and C (private creditors), with the issues of "entrustment" and "direction" relating primarily to the Group B and Group C creditors. Hynix' subsidy rate was set at 44.29%; Samsung received *de minimis* subsidy margins.[303] The Government of Korea (GOK) requested

300. *OCTG Sunset Review* Panel Report, *supra* note 218, ¶¶ 7.49-.51.

301. Notice of Initiation of Countervailing Duty Investigation: Dynamic Random Access Memory Semiconductors from the Republic of Korea, 67 Fed. Reg. 70,927-01 (Nov. 27, 2002).

302. Final Affirmative Countervailing Duty Determination: Dynamic Random Access Memory Semiconductors from the Republic of Korea, 68 Fed. Reg. 37,122-01 (June 23, 2003); *see also* Notice of Amended Final Affirmative Countervailing Duty Determination: Dynamic Random Access Memory Semiconductors from the Republic of Korea, 68 Fed. Reg. 44,290-01 (July 28, 2003).

303. Notice of Amended Final Affirmative Countervailing Duty Determination: Dynamic Random Access Memory Semiconductors from the Republic of Korea, 68 Fed. Reg. at 44,291.

consultations under the Dispute Settlement Understanding,[304] and when those failed to resolve the dispute a panel was formed. The Panel ultimately found the USDOC and the U.S. International Trade Commission's [USITC] determinations to be inconsistent with various provisions of the SCM Agreement.[305]

b. The Issues on Appeal

Had there been direct transfers of funds from Korea or a Korean government entity, this case would have taken on a very different posture under Article 1 of the WTO Agreement on Subsides and Countervailing Measures. Instead, the action before the Dispute Settlement Body focused on the *indirect* nature of the "financial contributions" and whether Korea's exercise of influence on Hynix' creditors to provide financing to an uncreditworthy company met the requirements of Article of 1.1(a)(1)(iv) of the SCM Agreement:

> For the purpose of this agreement, a subsidy shall be deemed to exist if . . . there is a financial contribution *by a government or any public body* . . . where:
> . . .
> a government makes payments to a funding mechanism, or *entrusts or directs a private body to carry out one or more of the types of functions illustrated in (i) to (iii)* [direct transfer of funds, foregoing revenue, providing goods or services] which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments.

Apart from an unsuccessful U.S. procedural challenge to Korea's request for consultations under Article 4.4 of the DSU,[306] the appeal turns largely on the proper interpretation of Art. 1.1(iv) of the SCM Agreement, the evidence used by the USDOC to reach its conclusion on the existence of the subsidy.

In particular, did the Panel err:

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304. *See generally* DSU.

305. SCM Agreement, *supra* note 276; Panel Report, *United States – Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors (DRAMS) from Korea*, WT/DS296/R, ¶ 8.1 (Feb. 21, 2005) [hereinafter *DRAM CVD* Panel Report].

306. See Appellate Body Report, *United States – Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors (DRAMS) from Korea*, WT/DS296/AB/R, ¶¶ 10-11, 88, 89-101 (June 27, 2005) [hereinafter *DRAM CVD* Appellate Body Report]. The Appellate Body upholds the Panel's conclusion that Korea's consultation request "did not fail to indicate the legal basis for the complaint in relation to the USDOC's CVD order, as required by Art. 4.4 of the *DSU*." *Id.* ¶ 101.

(1) in determining that "the action of the government must contain a notice of delegation (in the case of "entrustment") or command (in the case of "direction") in order to constitute "entrustment or direction" under Article 1.1(a)(1)(iv);
(2) in determining that the evidence before the USDOC was "sufficient for an objective and impartial investigating authority to properly find government entrustment or direction in respect of" the Korea First Bank, even though that bank did not ultimately carry out the activity allegedly entrusted to it;
(3) in finding that the evidence must be "probative and compelling," in failing to examine the evidence in its totality, in refusing to consider some record evidence not cited by the USDOC in the published determination;
(4) in finding that Korean domestic mediation provisions had been invoked despite a lack of supporting evidence, and in failing to apply the proper standard of review, thus acting inconsistently with the Panel's obligations under Article 11 of the *DSU*; and
(5) in finding that USDOC's benefit determination is inconsistent with Article 1.1(b) of the *SCM Agreement*; and that USDOC's specificity determination is inconsistent with Article 2 of the *SCM Agreement*.[307]

3. Holdings and Rationale

a. "Entrustment or Direction" under SCM Article 1.1(a)(1)(iv)[308]

The Panel concluded, with Korea's support, that "[i]t follows from the ordinary meanings of the two words 'entrust' and 'direct' that the action of the government must contain a notion of delegation (in the case of entrustment) or command (in the case of direction)."[309] The United States challenged this conclusion as overly narrow, arguing that the Panel had failed to "take []account of the full range of government actions that fall within the ordinary meaning[s] of th[ese] terms."[310] Korea separately contended that the evidence relied on by the

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307. *Id.* ¶ 88.

308. *DRAM CVD* Appellate Body Report, *supra* note 306, ¶¶ 102-126, unless otherwise noted.

309. *DRAM CVD* Panel Report, *supra* note 305, ¶ 7.31 (quoting Panel Report, *United States – Measures Treating Exports Restraints as Subsidies*, WT/DS194/R, ¶ 8.29 (June 29, 2001) [hereinafter *Export Restraints* Panel Report]).

310. United States' Appellant's Submission, *United States – Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors (DRAMS) from Korea*,

USDOC was not, as the Panel found, "sufficient for an objective and impartial investigating authority to properly find government entrustment or direction in respect of KFB."[311] In Korea's view, the Panel was also wrong in deciding that a finding of entrustment or direction was possible even when, as in the case of Korea First Bank (KFB), the entrusted and directed act was never actually undertaken.[312]

The Appellate Body began its analysis by analyzing the meaning of the two terms, "entrusts" and "directs." The financial contribution is, according to the Appellate Body, an:

> essential component of a "subsidy" under the *SCM Agreement*. No product may be found to be subsidized under Article 1.1(a)(1), nor may it be countervailed, in the absence of a financial contribution. Furthermore, situations involving exclusively private conduct—that is, conduct that is not in some way attributable to a government or public body—cannot constitute a "financial contribution" for purposes of determining the existence of a subsidy under the *SCM Agreement*.[313]

As the Appellate Body observed: "By virtue of paragraph (iv) [Article 1.1(a)(1)(iv), quoted in full in the 'Introduction and Explanation' section of this review], a financial contribution may also be provided *indirectly* by a government where it 'makes payments to a funding mechanism,' or as alleged in this case, where a government 'entrusts or directs a private body to carry out one of more of the type of functions illustrated in (i) to (iii)' . . . which would normally be vested in the government . . . ."[314] It is this situation in which a private body is being used as a "proxy" for the government that paragraph (iv) is designed to address.

The Appellate Body then noted that the Panel, in accepting the concept of a "notion of delegation" or "command" [see above], had replaced the statutory terms "entrusts" and "directs" with two other terms, "delegation" and "command," which terms were not defined or clarified by the Panel. The United States had objected on grounds that the Panel's approach had failed to consider other dictionary definitions of "entrust" such as "invest with a trust; give (a person, etc.) the responsibility for a task . . . ," and other definitions of "direct" such as "[c]ause to move in or take a specified direction" or "turn toward a specified destination or target." The United States thus argued that *all* dictionary definitions should have

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WT/DS296/AB/R, para. 24 (June 27, 2005) [hereinafter U.S.'s Appellant's Submission], *quoted in DRAM CVD* Appellate Body Report, *supra* note 306, ¶ 104.

311. *DRAM CVD* Panel Report, *supra* note 305, ¶ 7.117 *quoted in DRAM CVD* Appellate Body Report, *supra* note 306, ¶ 105.

312. Korea's other appellant's submission, para. 4.

313. *DRAM CVD* Appellate Body Report, *supra* note 306, ¶107.

314. *Id.* ¶ 108.

been included.[315] The Appellate Body in general agreed, deciding that limiting "entrusts" to acts of "delegation" and "directs" to "acts of command" was "too narrow," noting that "governments are likely to have other means at their disposal to exercise authority over a private body."[316]

Further, the Appellate Body cited with approval the panel decision in *US – Export Restrictions*,[317] in drawing a distinction between direct government actions providing a financial contribution (SCM Agreement, Articles 1.1(a)1(i)-(iii)) and those in which the contribution is provided indirectly (Article 1.1(a)(1)(iv)), where the difference is between the *actors*, not the *action.*[318] Thus, Korea is correct in that there "must be a demonstrable link between the government and the conduct of the private body." Also, according to the Appellate Body, paragraph (iv) is "in essence, a circumvention provision." Under those circumstances, if there is to be a finding of entrustment or direction, "the government [must] give responsibility to a private body—or exercise its authority over a private body—in order to effectuate a financial contribution," and not all government acts meet this requirement, as for example, "mere policy pronouncements."[319] Nor do the terms cover situations in which the government simply intervenes in the market, "which may or may not have a particular result simply based on the given factual circumstances and the exercise of free choice by the actors in that market." As the Appellate Body said in *US – Softwood Lumber IV*, "not all government measures capable of conferring benefits would necessarily fall within Article 1.1(a);" otherwise, paragraphs (i) to (iv) would not be necessary "because all government measures conferring benefits, *per se*, would be subsidies."[320]

This interpretation, according to the Appellate Body, is consistent with the object and purpose of the SCM Agreement; it "reflects a delicate balance between the Members that sought to impose more disciplines on the use of subsidies and those that sought to impose more disciplines on the application of countervailing measures."[321] This balance must be maintained when interpreting and applying paragraph (iv). Countervailing is permitted when private entities are used as a government proxy for providing a financial contribution, but not when a government "is merely exercising its general regulatory powers." For the Appellate Body, "entrustment" means the government giving responsibility to a private body, and "direction" refers to situations when the government exercises authority over the private body. Whether this proxy situation exists is to be determined based on the particular facts of the case.

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315. U.S.'s Appellant's Submission, *supra* note 310, paras. 19-20.

316. *DRAM CVD* Appellate Body Report, *supra* note 306, ¶ 111.

317. *Export Restraints* Panel Report, *supra* note 309, ¶ 8.29.

318. *Id.* ¶ 8.53, *quoted in DRAM CVD* Panel Report, *supra* note 305, ¶ 8.1.

319. *DRAM CVD* Appellate Body Report, *supra* note 306, ¶¶ 113-114.

320. *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, ¶ 64 (*adopted* May 16, 2004).

321. *DRAM CVD* Appellate Body Report, *supra* note 306, ¶ 115.

However, explicit (as distinct from implicit) government actions are not required:

> there may be other means by which governments can give responsibility to or exercise authority over a private body that may not fall within the terms "delegation" and "command" if these terms are strictly construed. When the Panel used their terms, it should have qualified them, and the Appellate Body *modifies* the Panel's interpretation of the terms to the extent the Panel Report implies such limits.[322]

#### b. Entrustment or Direction When Activities are not Carried Out

Nor is the fact that the private entity (in this case, KFB) ultimately declined to participate in the Fast Track Program[323] necessarily inconsistent with a finding of entrustment and direction, as Korea alleges.[324] According to the Appellate Body, the Panel's finding of entrustment or direction did not relate exclusively to that Program. "Depending on the circumstances, a private body may decide not to carry out a function with which it was so entrusted and directed, despite the possible negative consequences that may follow."[325] However, if the private body does not act, there is no financial contribution to the intended beneficiary, and no right to apply countervailing measures. Accordingly, Korea's challenge to the sufficiency of the evidence for the Panel's finding of government entrustment or direction with regard to KFB is rejected.

#### c. Panel's Review of the USDOC's Evidence[326]

The United States challenged the Panel's determination that USDOC "could not properly have found that there was sufficient evidence to support a generalized finding of entrustment or direction with respect to private bodies spanning multiple creditors and multiple transactions over the period of investigation."[327] The United States objected to an evidentiary standard of "probative and compelling" and the Panel's failure to consider the USDOC's evidence in its totality, rather than piecemeal. The Panel was also faulted for

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322. *Id.* ¶ 118.

323. Subsidized debentures designed to relieve Hynix from some of its debt burdens, issued at a price that would not have been justified on the commercial markets for an uncreditworthy firm such as Hynix.

324. Korea's other appellant's submission, para. 18

325. *DRAM CVD* Appellate Body Report, *supra* note 306, ¶¶ 123-124.

326. *Id.* ¶¶ 127-198, unless otherwise noted.

327. *DRAM CVD* Panel Report, *supra* note 305, ¶ 7.177.

refusing to admit certain evidence submitted by the United States during the Panel proceedings and for relying on evidence not on the record of the USDOC during the investigation.[328] These errors, in the aggregate, in the view of the United States resulted in a violation of Article 11 of the DSU, as they constituted a failure to apply the proper standard of review.

The Appellate Body began by summarizing the USDOC's findings that "numerous financial institutions, both public as well as private bodies, participated in financial transactions related to Hynix." (As mentioned earlier, the group A creditors were public bodies, including the Korea Development Bank, the Industrial Bank of Korea, and various other specialized banks. Group B creditors were GOK-owned or controlled private creditors, such as the Korean Exchange Bank and the KFB. Group C creditors were private entities in which Korea had small or no shareholdings, such as the KorAm Bank, Hana Bank, and Kookmin Bank.[329]) Various financial transactions were examined by the USDOC, including a December 2000 syndicated loan to finance short term debt maturing at that time, a KDB Fast Track Debenture program designed to address Hynix' liquidity crisis, a debt restructuring program agreed to by Hynix' creditors in May 2001, and a father debt restructuring program in October 2001.

Based on the evidence of the existence of these various programs, USDOC drew certain factual inferences, to wit, that there was (i) a Korean government "policy of supporting Hynix' restructuring and thereby avoiding the firm's collapse; (ii) the GOK exercised control or influence over Hynix' creditors necessary to implement this policy; and (iii) the GOK at times used this control/influence to 'pressure' or coerce Hynix' creditors to continue supporting the financial restructuring of the firm."[330] The USDOC's entrustment or direction conclusion thus covered almost all of Hynix' creditors, regardless of class or ownership. (Obviously, financial support provided from the Group A creditors—public bodies controlled by the GOK—was not really at issue; it was a subsidy to the extent it provided a benefit to Hynix.)

The U.S. critique of the Panel's approach is based on the "probative and compelling" standard the Panel set for evidence of entrustment or direction. The United States concedes that any evidence by its nature must be probative, but that there is no requirement in the SCM Agreement or the DSU for a standard of "compelling" evidence. This is in effect a standard of "overwhelming" or "irrefutable" evidence.[331] The Appellate Body essentially agreed. Under Article 12 of the SCM Agreement:

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328. U.S.'s Appellant's Submission, *supra* note 310, paras. 47, 94, 101.

329. *DRAM CVD* Appellate Body Report, *supra* note 306, ¶ 131.

330. *Id.* ¶ 135 (citing Final Affirmative Countervailing Duty Determination: Dynamic Random Access Memory Semiconductors from the Republic of Korea, 68 Fed. Reg. 37,122-01 (June 23, 2003)).

331. U.S.'s Appellant's Submission, *supra* note 310, para. 47; *DRAM CVD* Appellate Body Report, *supra* note 306, ¶ 137.

> a decision of the investigating authority as to the existence of a subsidy "can only be based on" evidence of the record of that agency; this applies equally to evidence used to support a finding of a financial contribution . . . . Beyond this requirement, however, we see no basis in the *SCM Agreement* or the *DSU* to impose on an investigating authority a particular standard for the evidence supporting its finding of entrustment or direction.[332]

However, the Panel did not err. It did not require that the evidence be "irrefutable," but only that it "demonstrate" entrustment or direction with regard to each of the private bodies alleged to have made a financial contribution. The Panel required only that the USDOC's evidence support the agency's conclusion, an evidentiary standard that is found in the SCM Agreement.[333]

Did the Panel wrongly fail to appreciate that the USDOC relied on the totality of the evidence, or restrict the agency from drawing "legitimate inferences," as the United States asserts? Did it, in so doing, wrongly shift the burden of proof from Korea to the United States?[334] The Panel *said* that it was basing its determination on the totality of the evidence before the USITC, but in fact, according to the Appellate Body, it followed a different approach.[335] The Panel, rather than relying on the totality of the evidence, decided that it had to assess the "probative value of each evidentiary factor separately."[336] It then investigated the pieces of evidence individually.

This in itself, said the Appellate Body, is not a problem. The Panel may well have to look at each individual piece of evidence in order to assess the sufficiency of the evidence overall. However, here, the Panel appeared to "examine whether each piece of evidence, viewed *in isolation*, demonstrated entrustment or direction"[337] and effectively accused the USDOC of inferring from individual pieces of evidence—such as the waiver of loan limits—that entrustment or direction had occurred. Rather, observed the Appellate Body, USDOC relied on multiple pieces of evidence (e.g., documents showing that a government agency representative had attended a Creditors' Council meeting to pressure Hynix' creditors to participate in the financial restructuring) in making its determination. The USDOC did not suggest that this action alone "amounted to" entrustment or direction.[338] After reviewing other examples,[339] the Appellate Body concluded that:

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332. *DRAM CVD* Appellate Body Report, *supra* note 306, ¶ 138.
333. *Id.* ¶¶ 139-140.
334. U.S.'s Appellant's Submission, *supra* note 310, paras. 58-87.
335. *DRAM CVD* Appellate Body Report, *supra* note 306, ¶¶ 142-143.
336. *DRAM CVD* Panel Report, *supra* note 305, ¶ 7.45.
337. *DRAM CVD* Appellate Body Report, *supra* note 306, ¶ 146.
338. *Id.* ¶ 147.

> [I]f, as here, an investigating authority relies on individual pieces of circumstantial evidence viewed together as support for a finding of entrustment or direction, a panel reviewing such a determination normally should consider that evidence in its totality, rather than individually, in order to assess its probative value with respect to the agency's determination.[340]

Failure to take this approach by the Panel "risks constructing a case different from that put forward by the investigating authority. In so doing, the panel ceases to *review* the agency's determination and embarks on its own *de novo* evaluation of the investigating authority's decision."[341] Under these circumstances, the Panel "erred in failing to examine the USDOC's evidence in its totality, and requiring, instead, that individual pieces of evidence, in and of themselves, establish entrustment or direction by the GOK of Hynix' creditors."[342]

Korea also criticized the Panel for permitting the United States to rely on evidence that although contained in the record had not been specifically cited in the USDOC's decision. According to Korea, "all relevant information on the matters of fact and law" should be included in the published determination.[343] Korea relies on Article 22.5 of the SCM Agreement, which requires that the agency's final determination contain "all relevant information on the matters of fact and law and reasons which have led to the imposition of final measures." The Appellate Body confirms that a Member may not seek to defend an agency decision based on evidence not in the record. However, that is not what occurred here, because the facts relied on by the United States before the Panel *were* contained in the administrative record. For the Appellate Body, Article 22.5 "does not require the agency to cite or discuss *every* piece of supporting record evidence for each fact in the final determination" and thus Article 22.5 does not support exclusion of such evidence.[344] Thus, the Panel erred in refusing to consider that record evidence.

#### d. Panel Reliance on Evidence of Mediation; Standard of Review

339. *See id.* ¶¶ 155-157 (recounting some of the evidence of Korean government pressure and threats on private lending institutions to provide emergency financing to Hynix).

340. *Id.* ¶¶ 148-150.

341. *Id.* ¶ 151. This is not permitted. *See* further discussion *infra* part (d).

342. *Id.* ¶ 158.

343. Korea's appellee's submission, paras. 183-184, *quoted in DRAM CVD* Appellate Body Report, *supra* note 306, ¶¶ 159-160.

344. *DRAM CVD* Appellate Body Report, *supra* note 306, ¶ 165.

The United States contended that the Panel itself erroneously relied on evidence that was not in the record. This related to the application of the Corporate Restructuring Promotion Act (CRPA), a Korean law which provided, *inter alia*, that creditors representing seventy-five percent of the holder's of the firm's outstanding debt could set the restructuring terms, with a mechanism through which the dissenting creditors could be bought out by the remaining creditors, at a price to be determined through consultation. There was also provision in the CRPA for creditors who wished to opt out to seek mediation in order to set the buy-out price, in the absence of agreement. This was considered important because if a significant number of creditors had exercised their mediation rights after opting out of the restructuring it would have undercut the argument that they had been "directed" by the GOK to participate. Korea and Hynix had asserted before the USDOC that three creditors had in fact exercised their opt-out rights; the USDOC concluded that notwithstanding these three, the terms of their opting out were effectively dictated by the important banks, that is the group A and B creditors, without any discussion of whether mediation had occurred.[345]

This assertion was not accepted by the Panel. Rather, the Panel asserted that evidence existed in the USDOC's record to show that the mediation provisions *had* been invoked, evidence that if true would tend to undercut control by the group A and B creditors (responding to Korean government entrustment and direction). The United States contended that there was no evidence that any creditors had invoked the right of mediation, other than evidence submitted by Korea to the Panel but never to the USDOC.[346]

The Appellate Body reiterated its conclusion in *US – Cotton Yarn* that a panel may not fault the investigating authority for not considering facts it could not reasonably have known: "Where a panel reads evidence with the 'benefit of hindsight,' it fails to consider how the evidence should have fairly been understood at the time of the investigation, and thereby fails to make an 'objective assessment' in accordance with Article 11 of the DSU."[347]

This is what happened in the present case. According to the Appellate Body, the evidence before the USDOC at best indicated that three creditors had raised objections to the buy-out price; neither the CRPA nor the raising of objections *per se* supports the Panel's conclusion "that the USDOC should have understood the 'rais[ing]' of 'objections' to include the recourse to mediation by three Hynix creditors."[348] The Panel was thus wrong in concluding that the

345. *Id.* ¶¶ 167-169.

346. *Id.* ¶¶ 171-172.

347. *United States – Transitional Safeguard Measures on Combed Cotton Yarn from Pakistan*, WT/DS192/AB/R, ¶ 174 (*adopted* Nov. 5, 2001) *quoted in DRAM CVD* Appellate Body Report, *supra* note 306, ¶ 175.

348. *DRAM CVD* Appellate Body Report, *supra* note 306, ¶ 177.

USDOC should have made a factual inference from this evidence and asserting that the mediation provisions had actually been invoked.

The United States, in the context of the Panel's consideration of the evidence before the USDOC, also alleged that the Panel had effectively failed to apply the proper standard of review as set out in Article 11 of the DSU: "[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 . . . ." Korea contended, in contrast, that the Panel properly engaged in an "in-depth review."[349] The Panel had articulated its standard of review, based on *US – Lamb*,[350] stating in pertinent part that "we shall determine whether an objective and impartial investigating authority, looking at the same evidentiary record as the [US]DOC and the [US]ITC, could properly have reached the same conclusions as did those agencies."[351]

The Appellate Body began by noting its prior jurisprudence (*US – Steel Safeguards*) barring the Panel from conducting a *de novo* review.[352] The standard of review articulated under the Agreement on Safeguards[353] is instructive for cases under the SCM Agreement that also involve agency decisions. Nevertheless, we recall that an "objective assessment" under Article 11 of the DSU must be understood in the light of the obligations of the particular covered agreement at issue in order to derive the more specific contours of the appropriate standard of review.[354]

The required "objective assessment," according to the Appellate Body, is "informed" by an examination of whether the investigating authority provided a "reasoned and adequate explanation" of how the evidence on the record supported its findings and how those findings supported the ultimate determination of a subsidy. However, the Panel must not second-guess the agency. Rather, the Appellate Body, reflecting a Chevron-style analysis,[355] states that: "A Panel may

349. *Id.* ¶¶ 180-181.

350. *United States – Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia*, WT/DS177/AB/R, WT/DS178/AB/R, (*adopted* May 16, 2001).

351. *DRAM CVD* Panel Report, *supra* note 305, ¶ 7.3.

352. *DRAM CVD* Appellate Body Report, *supra* note 306, ¶ 184, *citing United States – Definitive Safeguard Measures on Imports of Certain Steel Products*, WTDS166/AB/R et al. (*adopted* Dec. 10, 2003).

353. WTO Agreement on Safeguards, *available at* http://www.wto.org.

354. *DRAM CVD* Appellate Body Report, *supra* note 306, ¶ 184.

355. Chevron v. Natural Resources Defense Council, 467 U.S. 837, 843-45 (1984) (standing generally for the proposition that a reviewing court in the United States should afford a high degree of deference to the decisions of administrative agencies under review, respect the agency's construction of the statutory scheme the agency is entrusted with administering, and avoid reversal even where the court might on first impression have decided the issue differently).

not reject an agency's conclusions simply because the panel would have arrived at a different outcome if it were making the determination itself."[356] The Panel, after all, is a reviewer of agency action rather than a trier of facts.

In this case, the Panel erred. As discussed earlier, it reviewed pieces of evidence individually to determine their sufficiency to support certain USDOC conclusions, rather than reviewing the evidence in its totality. It also erroneously excluded certain evidence from the Panel proceeding that was found in the agency record and relied on certain other evidence that was not before the USDOC in the investigation. Those errors, taken together, amount to a failure by the Panel to apply the proper standard of review and a failure to comply with the requirements of Article 11 of the DSU.[357] Moreover, because of these evidentiary errors amounting to a violation of Article 11 and the Panel's incomplete reading of the terms "entrusts" and "directs," the Appellate Body concludes that the Panel's invalidation of the USDOC's finding of entrustment or direction was wrong, and is reversed.[358]

Under the circumstances, the Appellate Body was faced with the dilemma of "completing the analysis." As usual, it refused to do so, noting that in this case, "completing the analysis would require us to examine anew the entire USDOC finding of entrustment or direction." However, the participants have not addressed certain key issues—whether the probative value of the evidence is affected by the Panel's interpretation of "entrusts" and "directs" or by exclusion of certain of USDOC's evidence, the relevance of certain factual disagreements, and the inferences that may be reasonably drawn—that would be essential to this process. Thus, the Appellate Body review was limited to issues of law covered in the Panel Report and legal interpretations developed by the Panel.[359]

#### e. Benefit and Specificity

While the Appellate Body had not decided if the USDOC's determination of entrustment or direction was actually supported by sufficient evidence, it nevertheless turned to the questions of benefit and specificity, both of which must be determined under Articles 1 and 2 of the SCM Agreement if a subsidy is to be actionable.[360]

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356. *DRAM CVD* Appellate Body Report, *supra* note 306, ¶ 187.

357. *Id.* ¶ 190.

358. *Id.* ¶¶ 192-193.

359. *Id.* ¶¶ 196-197.

360. Article 1 of the SCM Agreement provides: "For the purpose of this agreement, a subsidy shall be deemed to exist if [the government provides financial contributions] . . . and a benefit is thereby conferred." Article 2 provides rules to determine whether a subsidy is "specific to an enterprise or industry or group of enterprises or industries" and thus actionable, or is generally available and exempt from action by another Member. SCM Agreement, *supra* note 276.

The Panel had criticized the USDOC's benefit analysis because it was based on the conclusion that the Group B and C creditors (those in which the GOK had an interest, and those that were privately owned) were entrusted or directed by Korea to participate in the various financial restructuring programs at issue. The USDOC had rejected the interest rates charged by these institutions as market benchmarks for determining the existence of a benefit for the same reason. Since the Panel had rejected USDOC's finding regarding entrustment and direction, it rejected the parallel finding that the private creditors' interest rates could not have been a proper benchmark.[361] Likewise, the Panel considered that the USDOC's finding of specificity was also based on the finding of entrustment and direction.[362]

Notwithstanding Korea's assertions to the contrary, the Appellate Body observed that the Panel "expressly indicates that, in light of its finding that the USDOC's determination of benefit was inconsistent with Article 1.1(b) because it was premised on an improper finding of entrustment and direction, 'it is not necessary . . . to examine other issues raised by the parties regarding market benchmarks.'"[363] Thus, the Appellate Body concurred with the United States that the Panel's finding that the USDOC's benefit determination was inconsistent is "premised exclusively" on the Panel's finding on entrustment or direction. Consequently, this Panel determination was to be reversed as well.[364] The same was true with regard to the Panel's finding of specificity, as both Korea and the United States agreed. Accordingly, the Appellate Body reversed that Panel finding as well, noting in passing that because the Panel's determination on entrustment or direction was the sole basis for its finding on benefit and specificity, the Appellate Body offered "no view as to the consistency of the USDOC's underlying determinations of benefit and specificity."[365]

4. Commentary

This case is not in any way a landmark, but it does illustrate some interesting aspects both of Panel and Appellate Body procedure.

First, the decision fails to resolve what is perhaps inevitable confusion over the precise meaning of "entrusts" and "directs" in the context of determining the existence of government action under Article 1.1 of the SCM Agreement. The

361. *DRAM CVD* Panel Report, *supra* note 305, ¶ 7.190.

362. *Id.* ¶¶ 7.206, .208, *quoted in DRAM CVD* Appellate Body Report, *supra* note 306, ¶ 201. Otherwise, there would have been little question, since the alleged subsidies were devoted to a single entity, Hynix, and the issue of entrustment and direction related to Korean government actions with regard to private creditors participating in the financial restructuring of Hynix alone.

363. *DRAM CVD* Appellate Body Report, *supra* note 306, ¶ 204.

364. *Id.* ¶¶ 204-205.

365. *Id.* ¶¶ 206-208.

Appellate Body's rejection of the Panel's relatively narrow definition, and the substitution of its own, "'entrustment' occurs when a government gives responsibility to a private body, and 'direction' refers to situation where the government exercises its authority over a private body,"[366] is not in itself terribly helpful; the sufficiency of an investigating authority determination will no doubt continue to be considered on a case by case basis. However, investigating authorities in general, and the USDOC in particular, can take comfort from the fact that the Appellate Body has definitely rejected a narrow definition of these key terms. In the future, governments that wish non-governmental entities to carry out various economic policies to maintain the viability of an important industry will have to be more careful with their approaches to the non-governmental entities in order to avoid the risk of providing countervailable subsidies. However, there is no assurance that a less "directing" and "controlling" approach (and thus safe from a countervailing duty action) will have the desired effect of encouraging private financial institutions to act in the manner desired (but not "directed") by the government.

Second, with regard to the extensive discussion of the process of evaluating evidence and applying the proper standard of review, one can again wish that the drafters of the SCM Agreement had adopted the more explicit standard of review embodied in Article 17.6(1) of the AD Agreement:[367]

> [I]n its assessment of the facts of the matter, the panel shall determine whether the authorities' establishment of the facts was proper and whether their evaluation of those facts was unbiased and objective. If the establishment of the facts was proper and the evaluation was unbiased and objective, *even though the panel might have reached a different conclusion, the evaluation shall not be overturned.*

This Chevron-type standard, giving a high degree of deference to the agency, exists solely in the AD Agreement. All of the other covered agreements are subject to the more vague strictures of Article 11 of the DSU. However, in *US – DRAMs CVD*, the Appellate Body has incorporated a key element of Article 17.6 into the more general standard of agency review, that is, that disagreement by the Panel with the agency's determination is not a sufficient basis for rejecting the agency's conclusions.[368] While this concept may have been incorporated in earlier Appellate Body decisions, it has seldom been articulated with this clarity. Certainly, some current or former USTR attorneys may take some comfort from this decision, in that earlier arguments made by the United States that an Article

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366. *Id.* ¶¶ 106-116.

367. Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, annex 1A, art. VI, Apr. 15, 1994, 33 I.L.M. 1125 (1994).

368. *See DRAM CVD* Appellate Body Report, *supra* note 306, ¶ 187.

17.6 type standard should be applied beyond the AD Agreement may be taking hold with the Appellate Body.[369]

Finally, the justifiable refusal of the Appellate Body here to "complete the analysis" again underlines the desirability of a modification of the DSU that would permit the Appellate Body to remand cases to the panels for further factual determinations consistent with the legal conclusions reached by the Appellate Body. Such changes have been proposed,[370] but to date changes have not been adopted.

Korea and the United States notified the DSB on Nov. 7, 2005, that they had agreed that the reasonable period of time for the United States to implement the DSB's recommendations would be seven months and sixteen days, or by March 8, 2006.[371]

## C. Anti-Dumping and Countervailing Duties and the Period of Investigation

### 1. Citation

*Mexico – Definitive Anti-Dumping Measures on Beef and Rice, Complaint with Respect to Rice*, WT/DS295/AB/R (issued November 29, 2005, adopted December 20, 2005) (complaint by United States).

### 2. Facts[372]

On 2 June 2000, the Mexican Rice Council filed an anti-dumping (AD) petition with the investigating authority at the time in Mexico for AD matters—

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369. Despite efforts by the United States to argue that Article 17.6 of the AD Agreement should be applied in other contexts, such as the SCM Agreement, the Appellate Body has refused to do so. For example, in *US – Lead and Bismuth II*, it concluded that "By implication, this decision [on review of article 17.6 of the Antidumping Agreement] supports our conclusion that the Article 17.6 standard applies only to disputes arising under the Antidumping Agreement, and not to disputes arising under other covered agreements, such as the SCM Agreement." *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/AB/R, ¶ 50 (*adopted* Jun. 7, 2000).

370. *See, e.g.*, *Special Session of the Dispute Settlement Body, Report by the Chairman*, TN/DS/14, Nov. 25, 2005, *available at* http://docsonline.wto.org/DDFDocuments/t/tn/ds/14.doc (listing remand as one of the issues under discussion by the Trade Negotiations Committee to "improve and clarify" the DSU).

371. *WTO Dispute Update*, *supra* note 20, *at* 177.

372. *See* Appellate Body Report, *Mexico – Definitive Anti-Dumping Measures on Beef and Rice*, WT/DS295/AB/R, ¶¶ 1-11, 147-149, 190-195, 198, 234-235 (Nov. 29, 2005) [hereinafter *Rice* Appellate Body Report].

the Ministry of Commerce and Industrial Development (SECOFI). In December 2000, the Ministry of the Economy—called *Economía*—superseded SECOFI and took up the investigation. (Essentially, the name of SECOFI was changed to *Economía*.) *Economía* sent notice of initiation of the investigation to the U.S. Embassy in Mexico City, explaining that any interested party had thirty days to appear before *Economía*. Accordingly, *Economía* sent the U.S. government, as well as the two exporters specifically named in the petition—"Producers Rice Mill, Inc." and "Riceland Foods, Inc."—copies of the petition and investigation questionnaire. After the investigation was initiated, but before a preliminary determination, two other U.S. exporters, "The Rice Company" and "Farmers Rice Milling Company," plus an industry association, the "U.S.A. Rice Federation," requested copies of, and completed, the questionnaire.

The subject merchandise was long-grain white rice from the United States. For the dumping margin determination, the period of investigation (POI) was 1 March to 31 August 1999, i.e., six months. *Economía* assigned individual dumping margins to all four American exporters that participated in the investigation. For the "residual" dumping margin, i.e., the margin for all other U.S. exporters of subject merchandise that did not come forward, *Economía* used facts available to calculate the dumping margin. The petitioner provided the "facts available." In its final determination, *Economía* said Farmers Rice Milling Company and Riceland Foods, Inc., had not been dumping. So their rice shipments attracted a zero AD duty. But, *Economía* calculated a dumping margin for The Rice Company, Inc., of 3.93% and imposed an AD duty on that amount. As for Producers Rice Mill, Inc., and for all other American exporters of rice (i.e., the residual rate), *Economía* calculated a 10.18% dumping margin and imposed a corresponding AD duty.

Much of the WTO litigation concerns the POI for the injury determination. *Economía* collected data for the continuous period of March 1997 through August 1999. However, *Economía* based its injury analysis on data for 1 March to 31 August for the years 1997, 1998, and 1999. That is, *Economía* had data for two and one-half consecutive years, but, it excluded one year's worth of data, from 1 September 1997 to 28 February 1998, and from 1 September 1998 to 28 February 1999. Thus, *Economía* relied on one and one-half year's worth of data, limiting its analysis to March through August of 1997, 1998, and 1999.

There were three significant temporal gaps in the case. *Economía* initiated its AD investigation on 11 December 2000. This date was six months after it received the petition (2 June 2000). This date was about fifteen months after the end of the POI (31 August 1999). On 5 June 2002, *Economía* issued a final affirmative AD determination through which it imposed AD duties. Thus, there was a gap of just under three years between the end of the POI and imposition of the duties. In sum, six months went by between petition submission and initiation, fifteen months went by from the POI to initiation, and three years went by from the POI to the remedy.

To be sure, the WTO AD Agreement does not specify any rules on the period to be used for collecting data in an AD investigation. However, as the Panel rightly observed, this lacunae does not mean an investigating authority has boundless discretion to set a POI. As the Panel put it, there is an "inherent real-time link" between imposing a remedy and the reasons for doing so, namely, the existence of dumping that causes injury.[373] Rarely, if ever, can the link be perfect. There is an inevitable delay associated with the practical need to conduct an investigation. In every case, historical data is used to draw a conclusion about a current situation. But, "to the extent practically possible," said the Panel, this link should be as tight as possible.[374] That is because the point of the remedy is to counterbalance injurious dumping. If the link is attenuated, then the kind of rebalancing envisioned by GATT Article VI and the AD Agreement does not occur. To create as tight a link as possible, data that are more recent should be considered more relevant.

The POI *Economía* used was suggested by the domestic industry in its 2 June 2000 AD petition. *Economía* accepted the suggestion, despite the fifteen month gap between the end of the POI and start of the investigation. During the investigation, *Economía* did not try to update any of the information it collected from interested parties, i.e., it did not try to find out what happened between the end of the POI in August 1999 and the start of the investigation in December 2000. In the WTO action, Mexico did not explain why *Economía* made no such effort and did not argue that practical problems either necessitated the use of the POI or prevented the updating of data.

Likewise, the petitioners also suggested that *Economía* use the six month period from March to August of 1997, 1998, and 1999 for the injury determination. This period showed the most negative side of the state of the domestic industry. It reflected the highest import penetration of the subject merchandise, long-grain white rice. Imports of this rice tended to be concentrated during March through August. Moreover, *Economía* accepted a link to production and imports of paddy rice, which is the raw material to produce the subject merchandise, and imports of the subject merchandise. Subject merchandise imports peaked during March through August because paddy rice is not harvested during that time.

In coming to a final injury determination, *Economía* considered whether dumped imports were the cause of volume and price effects that evinced injury. It reached an affirmative answer via the following methodology:

- *Rice Export Volumes from the Four Investigated Companies*:

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373. *Id.* ¶ 148 (quoting Panel Report, *Mexico – Definitive Anti-Dumping Measures on Beef and Rice*, WT/DS295/R, ¶ 7.58 (June 6, 2005) [hereinafter *Rice* Panel Report]).

374. *Rice* Appellate Body Report, *supra* note 372, ¶ 148 (quoting *Rice* Panel Report, *supra* note 373.).

By necessity, *Economía* distinguished between subject rice imports, i.e., the subject merchandise, long-grain white rice, from all types of imported rice. This issue arose because the tariff line in the HS for long-grain white rice is 1006.30.01, which (at the time of the investigation) was the same tariff code for other kinds of rice, such as short-grain and medium-grain rice, glazed rice, and parboiled rice, which were not subject to the investigation.

To delineate subject from non-subject merchandise, *Economía* requested information from each of the four companies participating in the investigation. One firm said it had not exported rice during the POI so it did not provide statistics. Of the other three companies, *Economía* said only one of them—Farmers Rice Milling Company—gave correct information for the whole period. *Economía* decided that neither The Rice Company, Inc. nor Riceland Foods, Inc. provided accurate data. Hence, *Economía* discarded the data the two companies submitted.

As for Farmers Rice, exports of its rice to Mexico increased by 303.7% in March through August 1998 (compared to the previous corresponding period). It grew by 12.3% during March though August 1999 (compared to the previous corresponding period). *Economía* used the variation in the volume of rice exports from Farmers Rice as an acceptable indicator of the behavior of rice export volumes from The Rice Company and Riceland.

● *Rice Import Volumes from Non-Investigated Companies*:

Also in connection with differentiating subject and non-subject merchandise, *Economía* determined the volume of rice exported by firms other than the four companies that participated in the investigation. *Economía* relied on the methodology of the petitioner. Any rice imported below a certain price level was treated as subject merchandise (long-grain white rice). Any rice imported above that price level was not treated as subject merchandise.

*Economía* admitted this methodology did not provide accurate data for 1997 and 1998. But, it sought to overcome the inaccuracies by assuming the share of subject merchandise imports in the total imports of all types of rice was the same in 1997 and 1998 as it was in 1999. On that assumption, *Economía* said that subject merchandise imports from companies other than the four participants increased by 8.6% in March through August 1998 (compared to the same period in 1997), and by 3.4% in

March through August 1999 (compared to the same period in 1998).

● *Distinguishing Dumped from Non-Dumped Subject Merchandise*:

Also by necessity, *Economía* distinguished between imports of subject merchandise that were dumped into Mexico versus rice imports that were not dumped. *Economía* did so by taking the total volume of subject merchandise imports, and subtracting from this total the amount of imports from the four companies that participated in the investigation for which no dumping margin was found. As explained below, *Economía* found that Farmers Rice and Riceland did not dump rice into Mexico. Hence, *Economía* subtracted their rice exports from the total volume, to yield the amount of dumped subject merchandise.

● *Price Effects*:

Regarding the price effects of dumped imports, specifically, the prices of the subject merchandise and their effects on the prices in the Mexican market of long-grain rice, *Economía* compared prices of (1) all kinds of rice (i.e., subject and non-subject rice), (2) the export price of Farmers Rice (for which there was no dumping margin), and (3) the export price of remaining imports (both dumped and non-dumped). *Economía* observed that the price of all rice (the broadest category) decreased during the POI. *Economía* also observed that the export price of Farmers Rice decreased during the POI. From this latter fact, *Economía* inferred that the prices of other imported rice, including of dumped rice, also decreased. Finally, *Economía* observed that during the POI, the price of dumped rice was not only below that of the domestic product, but also lower than the price of domestic rice in periods before the POI. *Economía* determined this situation provoked a decline in the prices of domestic producers.

To be sure, during the POI, rice imports from Argentina entered Mexico at reduced prices, and the price of non-dumped American rice also declined. These two factors contributed to the decline in the price of domestic products. Nevertheless, said *Economía*, dumped imports from the United States contributed to pressure on Mexican producers to lower their prices during the POI.

Accordingly, *Economía* judged injury caused by dumped imports, with the indicia of harm being increased volume and price depression.

3. Summary of Panel and Appellate Body Issues and Findings

The United States raised claims under the General Agreement on Tariffs and Trade (GATT), the WTO Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (AD Agreement), and the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement). In particular:

● As to the Dumping Margin Determination by *Economía* –

The United States alleged violations of GATT Article VI:2, Articles 1, 5.8, 6.1-2, 6.4, 6.6, 6.8, 6.10, 9.3-5, and 12.1-2 of the AD Agreement, plus Annex II thereto. The Panel held in favor of the United States with respect to Articles 5.8, 6.1, 6.8, 6.10, and 12.1 of the AD Agreement, and Paragraphs 1 and 7 of Annex II. The Appellate Body upheld the Panel's finding with respect to Article 5.8 and 6.8 of the AD Agreement, and Paragraphs 1 and 7 of Annex II.[375] However, the Appellate Body reversed the Panel as to Articles 6.1, 6.10, and 12.1 of the AD Agreement.[376]

Consequently, on appeal, there were two important dumping margin determination issues. The first such issue concerned Article 5.8 of the AD Agreement. This provision states:

> 5.8. An application under paragraph 1 shall be rejected and an investigation shall be terminated promptly as soon as the authorities concerned are satisfied that there is not sufficient evidence of either dumping or of injury to justify proceeding with the case. There shall be immediate termination in cases where the authorities determine that the margin of dumping is *de minimis,* or that the volume of dumped imports, actual or potential, or the injury, is negligible. The margin of dumping shall be considered to be *de minimis* if this margin is less than [two] per cent, expressed as a percentage of the export price. The volume of dumped imports shall normally be regarded as negligible if the volume of

375. *See id.* ¶¶ 5(a), 350(c)(i), (iv).
376. *See id.* ¶ 350(c)(iii).

> dumped imports from a particular country is found to account for less than [three] per cent of imports of the like product in the importing Member, unless countries which individually account for less than [three] per cent of the imports of the like product in the importing Member collectively account for more than [seven] per cent of imports of the like product in the importing Member.

At issue on appeal was whether the Panel erred in finding that Mexico did not terminate immediately the investigation of Farmers Rice Milling Company and Riceland Foods, Inc., because *Economía* did not exclude these two entities from application of the definitive AD measure, as Article 5:8 requires.[377]

The second dumping margin appellate issue concerned Articles 6.1, 6.8, 6.10, and 12.1 of the AD Agreement, and Paragraph 1 of Annex II to the Agreement. These provisions state:

> 6.1. *All interested parties in an anti-dumping investigation shall be given notice of the information which the authorities require* and ample opportunity to present in writing all evidence which they consider relevant in respect of the investigation in question.
>
>> 6.1.1. Exporters or foreign producers receiving questionnaires used in an anti-dumping investigation shall be given at least [thirty] days for reply. [A footnote states: "As a general rule, the time limit for exporters shall be counted from the date of receipt of the questionnaire, which for this purpose shall be deemed to have been received one week from the date on which it was sent to the respondent or transmitted to the appropriate diplomatic representative of the exporting Member or, in the case of a separate customs territory Member of the WTO, an official representative of the exporting territory."] Due consideration should be given to any request for an extension of the [thirty]-day period and, upon cause shown, such an

377. *See id.* ¶ 132(c)(i).

extension should be granted whenever practicable.

6.1.2. Subject to the requirement to protect confidential information, evidence presented in writing by one interested party shall be made available promptly to other interested parties participating in the investigation.

6.1.3. As soon as an investigation has been initiated, the authorities shall provide the full text of the written application received under paragraph 1 of Article 5 to the known exporters and to the authorities of the exporting Member and shall make it available, upon request, to other interested parties involved. [A footnote after the word "exporters" explains "[i]t being understood that, where the number of exporters involved is particularly high, the full text of the written application should instead be provided only to the authorities of the exporting Member or to the relevant trade association."] Due regard shall be paid to the requirement for the protection of confidential information, as provided for in paragraph 5.

. . .

6.8. *In cases in which any interested party refuses access to, or otherwise does not provide, necessary information within a reasonable period or significantly impedes the investigation, preliminary and final determinations, affirmative or negative, may be made on the basis of the facts available. The provisions of Annex II shall be observed* in the application of this paragraph.

. . .

6.10. The authorities *shall, as a rule, determine an individual margin of dumping for each known exporter or producer concerned of the product under investigation*. In cases where the number of exporters, producers, importers or types of products involved is so large as to make such a determination impracticable, the authorities may limit their examination either to a reasonable number of interested parties or products by using samples which are statistically valid on the basis of information available to the authorities at the time of the selection, or to the largest percentage of the volume of the exports from the country in question which can reasonably be investigated.

> 6.10.1. Any selection of exporters, producers, importers or types of product made under this paragraph shall preferably be chosen in consultation with and with the consent of the exporters, producers or importers concerned.
>
> 6.10.2. In cases where the authorities have limited their examination, as provided for in this paragraph, they shall nevertheless determine an individual margin of dumping for any exporter or producer not initially selected who submits the necessary information in time for that information to be considered during the course of the investigation, except where the number of exporters or producers is so large that individual examinations would be unduly burdensome to the authorities and prevent the timely completion of the investigation. Voluntary responses shall not be discouraged.

. . .

12.1. When the authorities are satisfied that there is sufficient evidence to justify the initiation of an anti-dumping investigation pursuant to Article 5, the Member or Members the products of which are subject to such investigation and *other interested parties known to the investigating authorities to have an interest* therein shall be notified and a public notice shall be given.

> 12.1.1. A public notice of the initiation of an investigation shall contain, or otherwise make available through a separate report, adequate information on the following:
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> > (i) the name of the exporting country or countries and the product involved;
> >
> > (ii) the date of initiation of the investigation;
> >
> > (iii) the basis on which dumping is alleged in the application;
> >
> > (iv) a summary of the factors on which the allegation of injury is based;

> > (v) the address to which representations by interested parties should be directed;
> > (vi) the time limits allowed to interested parties for making their views known.
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> [A footnote after the word "report" in the heading explains: "Where authorities provide information and explanations under the provisions of this Article in a separate report, they shall ensure that such report is readily available to the public."]
> . . .
> ANNEX II
> BEST INFORMATION AVAILABLE IN TERMS OF PARAGRAPH 8 OF ARTICLE 6
>
> 1. As soon as possible after the initiation of the investigation, the investigating authorities should specify in detail the information required from any interested party, and the manner in which that information should be structured by the interested party in its response. *The authorities should also ensure that the party is aware that if information is not supplied within a reasonable time, the authorities will be free to make determinations on the basis of the facts available, including those contained in the application for the initiation of the investigation by the domestic industry*.[378]

At issue on appeal was whether the Panel erred in its finding [that], with respect to exporters *Economía* did not individually investigate, Mexico violated these provisions.[379] The Panel ruled that *Economía* breached Articles 6.1 and 12.1 by failing to notify all interested parties of the initiation of the investigation, and of the information required of them. *Economía* violated Article 6.10 by not calculating an individual dumping margin for each exporter or producer that was known, or reasonably should have

378. Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 [hereinafter Antidumping Agreement], Annex II, Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, annex 1A, art. VI, Apr. 15, 1994, 33 I.L.M. 1125 (1994) (emphasis added).

379. *See Rice* Appellate Body Report, *supra* note 372, ¶ 132(c)(iii).

been known, to it. By using facts available in these circumstances, *Economía* ran afoul of Article 6.8 and Paragraph 1 of Annex 2. In reaching these conclusions, the Panel gave an expansive interpretation to the term "interested parties known to the investigating authorities" in Article 12.1. As explained below, the Appellate Body rejected this interpretation and overturned the Panel's holdings under Article 6.1 and 12.1, and, consequently, 6.10. Yet, the Appellate Body upheld the Panel's finding under Article 6.8—*Economía* was wrong to apply facts available to uninvestigated respondents to which *Economía* did not give notice of the investigation or of the information *Economía* needed for it.

● As to the Injury Determination by *Economía* –

The United States alleged violations of GATT Article VI:2, VI:6(a), and Articles 1, 3.1-2, 3.4-5, 6.2, 6.8, and 12.2 of the AD Agreement. The Panel found in favor of the United States with respect to Articles 3.1-2 and 3.4-5 of the AD Agreement. Specifically, the Panel held that *Economía* failed to make an injury determination based on "positive evidence" as required by Article 3.1, i.e., because *Economía* relied inexplicably on data from a POI that ended fifteen months before it initiated the investigation. In turn, under Articles 3.2 and 3.4-5, the Panel said the data could not support a showing of a causal relationship between dumped imports and injurious volume or price effects. The Panel also held that *Economía* did not conduct an "objective examination," as Article 3:1 requires, because it disregarded six months worth of data from the years of 1997, 1998, and 1999. Finally, the Panel concluded that *Economía* did not base its injury determination, as to the volume and price effects allegedly caused by dumped subject merchandise, on "positive evidence."

Accordingly, on appeal, the most important substantive issue in the entire case concerned Articles 3.1-2 and 3.4-5. Article 3.1-2 of the AD Agreement states:

> 3.1. A determination of injury for purposes of Article VI of GATT 1994 shall be based on *positive evidence* and involve an *objective examination* of both (*a*) the volume of the dumped imports and the effect of the dumped imports on prices in the domestic market for

> like products, and (*b*) the consequent impact of these imports on domestic producers of such products.[380]

Evidently, this provision mandates an injury determination be based on "positive evidence." Did the Panel err in finding that use by *Economía* of a POI ending in August 1999 resulted in an injury determination that was not based on "positive evidence," in contravention of Article 3.1, and, consequently, also of Articles 3.2 and 3.4-5?[381] These other Articles state:

> 3.2. With regard to the volume of the dumped imports, the investigating authorities shall consider whether there has been a significant increase in dumped imports, either in absolute terms or relative to production or consumption in the importing Member. With regard to the effect of the dumped imports on prices, the investigating authorities shall consider whether there has been a significant price undercutting by the dumped imports as compared with the price of a like product of the importing Member, or whether the effect of such imports is otherwise to depress prices to a significant degree or prevent price increases, which otherwise would have occurred, to a significant degree. No one or several of these factors can necessarily give decisive guidance.
>
> . . .
>
> 3.4. The examination of the impact of the dumped imports on the domestic industry concerned shall include an evaluation of all relevant economic factors and indices having a bearing on the state of the industry, including actual and potential decline in sales, profits, output, market share, productivity, return on investments, or utilization of capacity; factors affecting domestic prices; the magnitude of the margin of dumping; [and] actual and potential negative effects on cash flow, inventories, employment, wages, growth, ability to raise capital or investments. This list is not exhaustive, nor can one or several of these factors necessarily give decisive guidance.
>
> 3.5. It must be demonstrated that the dumped imports are, through the effects of dumping, as set forth in

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380. Antidumping Agreement, *supra* note 378, art. 3.1-2.
381. *See Rice* Appellate Body Report, *supra* note 372, ¶ 132(b)(ii).

> paragraphs 2 and 4, causing injury within the meaning of this Agreement. The demonstration of a causal relationship between the dumped imports and the injury to the domestic industry shall be based on an examination of all relevant evidence before the authorities. The authorities shall also examine any known factors other than the dumped imports which at the same time are injuring the domestic industry, and the injuries caused by these other factors must not be attributed to the dumped imports. Factors which may be relevant in this respect include, *inter alia,* the volume and prices of imports not sold at dumping prices, contraction in demand or changes in the patterns of consumption, trade restrictive practices of and competition between the foreign and domestic producers, developments in technology[,] and the export performance and productivity of the domestic industry.

As explained below, the Appellate Body found no such error, and upheld the Panel rulings.[382]

Article 3.1 also mandates that an injury determination be based on an "objective examination." The Panel found that *Economía* neglected this mandate, because it limited its injury analysis to six months (March-August) of the years 1997, 1998, and 1999.[383] Consequently, *Economía's* behavior also ran afoul of Article 3.5 of the AD Agreement. As explained below, the Appellate Body upheld these findings, too.[384] The Appellate Body also agreed with the Panel's conclusion that the injury analysis performed by *Economía*, as regards the volume and price effects of dumped imports, was inconsistent with Article 3.1-2 of the Agreement.[385]

The United States also made statutory challenges, alleging certain provisions of the Foreign Trade Act of Mexico (FTAM) concerning AD and CVD matters were inconsistent with various provisions of the AD and SCM Agreements.[386] They are discussed below, in the Commentary section.

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382. *See id.* ¶¶ 5(b), 158-172, 350(b)(ii).
383. *See id.* ¶ 132(b)(iii).
384. *See id.* ¶¶ 5(b), 173-188, 350(b)(iii).
385. *See id.* ¶¶ 5(b), 132(b)(iv), 189-206, 350(b)(iv).
386. On procedural and minor issues, at the Panel stage, the United States alleged provisions in Mexico's *Federal Code of Civil Procedure* were inconsistent with assorted

Articles in the AD and SCM Agreements. *See id.* ¶ 6. This matter was not an appellate issue.

The Appellate Body rendered the following procedural findings, which are not discussed in the text above:

● Terms of reference generally:
Did the Panel err under Article 6:2 of the DSU in finding the claims in the U.S. request for a panel that were not indicated in the U.S. request for consultations still came within the terms of reference of the panel? Upholding the Panel's finding, the Appellate Body concluded there was no error. *See Rice* Appellate Body Report, *supra* note 372, ¶¶ 132(a), 133-145, 350(a).

● Terms of Reference with respect to the dumping margin calculation on the basis of facts available:

Did the Panel exceed its terms of reference when it concluded *Economía* calculated a dumping margin on the basis of facts available for Producers Rice Mill, Inc., in a manner inconsistent with Article 6.8 of the AD Agreement and Paragraph 7, Annex II, to that Agreement? The Appellate Body held the Panel did not exceed its terms. *See id.* ¶¶ 132(c)(2), 222-233, 350(c)(ii).

● Terms of Reference with respect to injury determination:

Did the Panel exceed its terms of reference in concluding that the use of a POI by *Economía* ending in August 1999 was inconsistent with Articles 3.1-2 and 3.4-5 of the AD Agreement? The Appellate Body answered the Panel did not exceed its terms of reference. *See id.* ¶¶ 132(b)(i), 146-157, 350(b)(i).

● *Prima Facie* Case concerning FTAM with AD and SCM Agreements:

Did the Panel err in agreeing a *prima facie* case had been made out concerning the consistency of the challenged provisions of the FTAM with Mexico's obligations under the AD and SCM Agreements? The Appellate Body found no such error. *See id.* ¶¶ 132(d)(i), 267-270, 350(d)(i).

● Disregard of Mexican Argument concerning FTAM:

Did the Panel err by disregarding an argument made by Mexico concerning Article 2 of the FTAM, and thus by concluding the challenged FTAM provisions are mandatory measures? The Appellate Body found the Panel did not disregard the argument, and committed no error. *See id.* ¶¶ 132(d)(ii), 271-275, 350(d)(ii).

● Failure to Satisfy DSU Article 11:

The Panel held Article 93V of the FTAM is inconsistent with Article 18.1 of the AD Agreement and Article 32:1 of the SCM Agreement. The Appellate Body ruled the Panel satisfied its obligations under DSU Article 11 in coming to this conclusion. *See id.* ¶¶ 5 (g), 132(d)(vii), 325-330, 350(d)(vii).

4. Key Holdings and Rationale on the Dumping Margin Determination:[387]

*Economía* found that two exporters, Farmers Rice Milling Company and Riceland, Inc., did not dump subject merchandise during the POI. Nonetheless, *Economía* included them in the AD measure, albeit with a zero remedial duty. Should *Economía* have excluded them from application of the measure, i.e., in legal terms, did that coverage violate Article 5.8 of the WTO AD Agreement?

The Panel found that by not excluding Farmers Rice and Riceland, Mexico did not terminate immediately the AD investigation with respect to these non-dumping exporters, and after all, *Economía* breached Article 5.8. The second sentence of that provision requires immediate termination of an investigation of an exporter if the individual dumping margin for that exporter is zero or *de minimis*. This provision correlates with Article 6.10, which lays out a general obligation on AD authorities to determine an individual dumping margin for each exporter or producer. The Panel rejected Mexico's argument that *Economía* complied with Article 9.3, and, therefore, with Article 5.8. The two provisions are distinct: Article 9.3 concerns the amount of AD duty to be imposed or collected after establishing that a duty may be applied to a particular exporter or producer, whereas Article 5.8 is about initiating and conducting an investigation. In brief, once *Economía* found zero individual dumping for Farmers Rice and Riceland, it was obligated to exclude them from application of the AD order, and ascribing a zero duty does not suffice.

In reaching its conclusion, the Panel interpreted reference in Article 5.8 to the margin of dumping to mean an individual dumping margin determined on an exporter-specific basis. On appeal, Mexico challenged this interpretation, saying the reference is to a countrywide dumping margin. Thus, argued Mexico, termination is required only if the countrywide margin is zero or negative. "Wrong," said the Appellate Body, upholding the Panel's findings. Turning to *United States – Hot-Rolled Steel*, the Appellate Body cited this report for the proposition that a "margin" refers to the individual margin of dumping determined for each investigated exporter or producer of the subject merchandise.[388] Accordingly, the Panel was correct in its reading of the second sentence of Article 5.8; immediate termination is required for an exporter for which the individual dumping margin is zero or *de minimis*.[389]

Mexico also lodged an appeal of the finding by the Panel concerning the dumping margin calculation of *Economía*, using facts available for American

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387. *See Rice* Appellate Body Report, *supra* note 372, ¶¶ 207-264, unless otherwise noted.

388. *See id.* ¶ 216.

389. Mexico also offered, unsuccessfully, rather convoluted arguments about the text of Article 5.8 (specifically, the term "investigation" and phrase "an investigation shall be terminated promptly") and about the authority to impose an AD duty (rather than the duty itself) being a measure. *See id.* ¶¶ 211-213, 218, 220.

exporters that *Economía* did not investigate. The residual rate of 10.18% applied to uninvestigated exporters. To be sure, Article 6.8 entitles an investigating authority to apply facts available if an interested party refuses access to, or does not provide within a reasonable period, necessary information, or significantly impedes an investigation. However, did *Economía* breach the rule of Article 6.10 of the WTO AD Agreement that "authorities shall determine . . . an individual margin of dumping for each known exporter or producer concerned of the product under investigation?" The Panel emphasized the phrase "known exporter or producer," saying it refers to entities of which "an objective and unbiased investigating authority properly establishing the facts and conducting an *active* investigation *could have and should have reasonably been considered to have [obtained] knowledge*."[390] Just as the authority cannot remain passive in identifying the exporters or producers, it cannot be passive about giving notice to interested parties. If an interested party has not been properly notified and informed of the investigation and under Article 6.1 of the information it is supposed to submit, then it is impermissible to base a dumping margin for that party on facts available.

In the case at bar, the Panel held that *Economía* should have made a stronger effort to identify the U.S. exporters of subject merchandise. *Economía* could have obtained information about the American rice industry through the two industry associations mentioned in the petition and could have deduced from the petition that the list of exporters was incomplete. *Economía* also could have learned the identity of all American exporters of the subject merchandise by checking customs declarations. Finally, it could have checked publicly available sources like the rice industry magazine, *Rice Journal* (mentioned in the petition), and could have requested assistance from (rather than just notifying) the United States government to identify the exporters. In sum, the Panel concluded that *Economía* did not comply with the requirements of the notification and the information provisions in Articles 6.1 and 12.1 of the AD Agreement. *Economía* violated Article 6.10 by remaining entirely passive in not identifying the exporters or producers interested in the investigation and not calculating an individual margin for each exporter or producer it knew or reasonably should have identified. In turn, it violated both Article 6.8 and Paragraph 1 of Annex II of the Agreement by using facts available.

Mexico's appellate argument was that the Panel misread Article 6.10 to contain an obligation to determine an individual dumping margin for all exporters and producers. Mexico urged the correct reading is that calculating an individual margin for companies that took part in the investigation suffices. Moreover, *Economía* gave the requisite notice to the U.S. government. Contrary to footnote 15 of Article 6.1.1 of the Antidumping Agreement, the Panel made an erroneous assumption that diplomatic authorities have no duty to make their exporters or producers aware of the investigation. The Appellate Body agreed with Mexico as

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390. *Id.* ¶ 236 (quoting *Rice* Panel Report, *supra* note 373, ¶ 7.187) (emphasis added).

to Articles 6.1 and 12.1, and on Article 6.10, but rejected its arguments on Article 6.8, and on footnote 15.

Like Mexico, the Appellate Body looked askance at the interpretation the Panel rendered of the Article 12.1 phrase "interested parties known to the investigating authorities." The Panel said this term included not only exporters known to the investigating authority, but also exporters of which it can reasonably obtain knowledge. Perhaps a more succinct way to put the distinction is to borrow language from renowned U.S. Secretary of Defense, Donald Rumsfeld. The Panel said the phrase covers both "known knowns" (things about which one has actual knowledge) and "known unknowns" (things about which one knows that one does not know). The Appellate Body said it includes only "known knowns" (i.e., exporters of which an investigating authority has actual knowledge).

The text of Article 12.1 proves the correctness of the Mexican and Appellate Body position. This text unequivocally provides that an authority need notify only those exporters or producers of which it has actual knowledge at the time of initiation of the investigation. At that time, *Economía* knew of two exporters; Producers Rice and Riceland. Article 6.1, said the Appellate Body, must be interpreted in a symmetric manner—the full petition and questionnaire must be given to the known exporters.

The "known knowns" are exporters named in the petition, exporters that come forward voluntarily following issuance of public notice of the investigation under Article 12.1, and others that subsequently become known. But, the "known knowns" do not include exporters that an investigating authority reasonably should have identified. The Panel was wrong, held the Appellate Body, to extend Article 6.1 to exporters of which the investigating authority does not know, but of which it might reasonably obtain knowledge. Mexico was under no obligation to give notice, under Article 6.1 or 12.1, to exporters of which it did not know. Were the Panel correct, an authority would have a duty to undertake a potentially extensive inquiry to identify exporters. *Economía* did its job under Article 6:1 by sending an AD questionnaire to the exporters named in the petition (Producers Rice and Riceland), to the exporters that came forward on their own (The Rice Company and Farmers Rice), and to the industry association that did so (The U.S.A. Rice Federation).

The Appellate Body might have done well to buttress its conclusion with an observation about incentives. By delimiting the scope of Articles 6.1 and 12.1 to exporters of which an investigating authority has actual knowledge, incentives are rationally allocated to petitioners. That is, the petitioner ought to have the job of defining respondents in its pre-pleading investigation. A petitioner has every incentive to name as many exporters as it can, assuming it has a case for a positive dumping margin and injury caused by dumping. If an investigating authority filled in the blanks, then it would create a moral hazard problem. Petitioners could abuse AD law by attacking one or a few exporters, knowing that the authority will find the rest. In the end, some exporters might be vindicated with a *de minimis* or zero dumping margin, or a negative injury determination. But, the journey to that endpoint would be expensive for the exporters in terms of time, money, and reputation costs of defending the action. They might choose to settle, especially if, as can and does happen under U.S. AD law, the petitioner is afforded preliminary relief following affirmative preliminary injury and dumping margin determinations by the U.S. International Trade Commission and Department of Commerce, respectively.

The Appellate Body also reversed the Panel with respect to Article 6.10 of the WTO AD Agreement, which contains the general rule about calculating individual dumping margins. This rule applies to "each known exporter or producer." *Economía* did just that, computing margins for Producers Rice and Riceland (the named respondents), and The Rice Company and Farmers Rice (the exporters that identified themselves). The Panel was wrong to extend the scope of this phrase to cover companies about which an unbiased, objective investigating authority reasonably would be expected to have become conversant. The ordinary meaning of "known" exporter or producer does not include a company that is not known, but should have been known. Rather, the ordinary meaning of "known" includes the exporters or producers of which the investigating authority has actual knowledge at the time of calculating dumping margins. In brief, the Appellate Body logically held to a symmetric meaning of Article 6.10 as relating to Articles 6.1 and 12.1.

However, Mexico did not prevail in its appeal under Article 6.8 of the WTO AD Agreement. This provision, as the Appellate Body observes, references Annex II of the Agreement. The second sentence of Paragraph 1 of Annex II instructs an investigating authority to ensure that an interested party is aware that if it fails to supply requisite information in a reasonable time, the authority will be free to apply facts available, including data set out in the petition. In effect, the obligation is to admonish a respondent to supply information in a timely fashion or face facts that may be adverse to its interests. If an exporter is unknown to an investigating authority, then the authority does not (and need not) notify it of the investigation or information required of it. Obviously, an unknown, uninvestigated exporter is denied the opportunity to supply its own data. Is it then fair for an investigating authority to use facts available from the petition against such an exporter? "No," responded the Appellate Body—to do so would be to violate Paragraph 1 of Annex II, and, therefore, Article 6.8.

In this case, four American exporters, Producers Rice, Riceland, The Rice Company, and Farmers Rice, received notice of the information to submit to *Economía*. The U.S. exporters to which *Economía* did not give notice of the investigation, and which *Economía* did not investigate individually, manifestly were not notified of the information *Economía* needed. Yet, *Economía* used facts available from the petition against these exporters, and assigned them a 10.18% margin—higher than the individual margins of 3.93% (for The Riceland Company) and zero (for Farmers Rice and Riceland). That use of facts available against unknown, uninvestigated exporters was inconsistent with Annex II, Paragraph 1, and Article 6.8. Further, Mexico reads too much into Footnote 15 of

Article 6.1.1 of the AD Agreement to call it an obligation for diplomatic authorities to tell their exporters and producers of an investigation.

5. Key Holdings and Rationale on the Injury Determination and POI[391]

The Panel found the fifteen-month gap between the end of the POI and the initiation of the investigation by *Economía* to be an unacceptable hiatus. It was unacceptable because it was sufficiently long to impugn the data as "positive evidence" under Article 3.1 of the WTO AD Agreement. By "positive evidence," the Panel meant specifically that data are

- Relevant
- Pertinent
- Reliable
- Creditworthy

(Never mind the likelihood that two points would have sufficed: relevance and reliability. After all "relevance" and "pertinence" are synonyms.[392] "Creditworthy" is properly a banking term connoting reliability of repayment.) If evidence lacking these features is used to justify imposition of an AD duty, then the corrective function of GATT Article VI and the AD Agreement is undermined.

That corrective function is to permit a remedial duty to offset injurious dumping. If the evidence is not positive, then there is no assurance that the remedial duty is imposed under conditions in which injurious dumping occurs. To offer two metaphors the Appellate Body might have considered: (1) there is little sense carrying an umbrella after the rain has stopped and the sunshine is out (unless, of course, more rain is expected); or (2) no competent baseball pitcher throws to the previous batter (rather, he designs pitches against the batter he faces). Thus, whether to impose an AD duty must be considered in light of current conditions, using data that provides indications of the situation prevailing when the investigation occurs. True, a time lag between the data and the investigation is inevitable. But, the shorter the lag, the better.

The Article 3.1 violation had a serious consequence, namely, a knock-on breach of Articles 3.2, 3.4 and 3.5. With respect to these Articles, the Panel found that positive evidence did not exist to show a causal relationship between dumped imports and injury to the domestic industry.

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391. *See Rice* Appellate Body Report, *supra* note 372, ¶¶ 150, 158-206, unless otherwise noted.

392. *See* OXFORD AMERICAN DICTIONARY AND THESAURUS 1269 (2d ed. 2003) (entries for "relevant" and "reliable").

In its appeal of the Article 3.1 finding by the Panel, Mexico made four losing arguments. First, the Panel erred in saying that there is an "inherent real-time link" between an investigation and the data on which the investigation is based. Such a link is inconsistent with the option to use a past period as the POI. Second, the Panel contradicted itself because it acknowledged the impossibility of using a POI that coincides exactly with the time during which an authority conducts an investigation. Inevitably, the investigation gathers data from a POI that is in the past. Third, there is no textual basis in GATT Article VI or the AD Agreement for asserting a "real-time link" requirement. Finally, the Panel wrongly relied on a statement adopted on May 5, 2000 by the WTO Committee on Anti-Dumping Practices, namely, the *Recommendation Concerning the Periods of Data Collection for Anti-Dumping Investigations*. At best, the *Recommendation* is guidance, but has no legal basis for finding that remoteness of a POI *per se* implies a violation of the Agreement.

The Appellate Body easily turned away all four Mexican arguments. No, the Panel was not saying the POI and investigation must be contemporaneous. Using data from a past period does not *per se* entail a violation of the WTO AD Agreement (or, for that matter, GATT Article VI). The Panel recognized the long-held GATT-WTO principle that an injury determination may be based on a past period (the POI). The Panel simply and correctly explained that more recent data gives a better indication about current injury than older data. No, the Panel did not take the *Recommendation* as gospel. Rather, it acknowledged it to be a non-binding guide, which neither added to nor detracted from the obligations in the AD Agreement. And yes, the Panel had good reasons for doubting the relevance, pertinence, reliability, and creditworthiness of the data. A fifteen-month gap between the POI and initiation, and a three-year gap between the POI and the AD remedy, is a long time. *Economía* accepted the POI suggested by the petitioner, and Mexico could not explain why practical problems necessitated the POI, or why *Economía* failed even to try to update the data.

The Appellate Body also had an opinion on the selection by *Economía* of data from six of the twelve months (March through August) in 1997, 1998, and 1999. Limiting the injury analysis to half of each year cast doubt on whether *Economía* conducted an "objective examination," as Article 3.1 of the WTO AD Agreement obligated it to do. The Appellate Body agreed with the Panel that the examination was not objective. It was based on an incomplete set of data, characterized by selective use of data, and thus gave an inaccurate and biased picture. *Economía* deliberately accepted selective data advocated by the petitioner to highlight the highest import penetration of the subject merchandise, and thus the nadir of the domestic industry. Mexico urged that it was necessary to examine data relating only to the six months from March to August, because that period was used to demonstrate the existence of a dumping margin. In other words, said Mexico, *Economía* was trying to avoid distortions in comparing the POI for injury and the dumping margin by maintaining the same six-month structure.

Mexico also quibbled about two points. First, long-grain white rice imports were higher in March through August of 1998 and 1999, but not 1997. Even in the latter two years, the percentage by which March-August imports were higher was practically negligible. Thus, it was questionable whether the data used by *Economía* showed the most negative state of the domestic industry. Second, domestic production of long-grain white rice does not depend on the production cycles of paddy rice. When domestic paddy rice production drops, domestic producers of long-grain white rice rely on imported paddy rice, i.e., they switch from the local to foreign input. Thus, domestic production of long-grain white rice stays constant throughout the year.

"No matter," was the response from the Appellate Body. The Appellate Body, like the Panel, correctly replied that AD law does not require the POI for an injury determination to match exactly the POI for the dumping margin determination, especially if the latter POI is less than one year. Rather, the benchmark is objectivity, and here a precedent was relevant: the definition of "objective" in the *United States – Hot Rolled Steel* case. The *Mexico – Rice* Panel said "objectivity" requires use of data that provides "an accurate and unbiased picture" of the matter being examined. Right, observed the Appellate Body, for as the *Hot Rolled Steel* Appellate Body Report declares:

> [A]n "objective examination" requires that the domestic industry, and the effects of dumped imports, be investigated in an unbiased manner, without favouring the interests of any interested party, or group of interested parties, in the investigation. The duty of the investigating authorities to conduct an "objective examination" recognizes that the determination will be influenced by the objectivity, or any lack thereof, of the investigative process.[393]

Plainly, reasoned the Appellate Body, *Economía* flunked the objectivity test.

*Economía* used selectively the information it gathered, it accepted what the petitioners told it, and it knew the POI at six-month intervals showed the highest import penetration figures. How could Mexico possibly believe that using data for a whole year, instead of March through August, would have introduced distortions into the assessment of the state of the domestic industry? To the contrary, data for the entire years of 1997, 1998, and 1999 would have provided a relatively more accurate and unbiased picture of that condition. That is not to suggest using data from only a part of a year never is appropriate. There could well be valid reasons for doing so in a particular case—but Mexico certainly

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393. *Rice* Appellate Body Report, *supra* note 372, ¶ 180 (quoting Appellate Body Report, *U.S. – Antidumping Measures on Certain Hot Rolled Steel Products from Japan*, WT/DS184/AB/R, ¶ 193 (Jul. 24, 2001) [hereinafter *Hot Rolled Steel* Appellate Body Report]).

provided none. The violation of Article 3.1 had, once again, knock-on effects. Mexico breached Article 3.5, which calls for demonstration of a causal relationship between dumped imports and injury.

Additionally, both the Panel and Appellate Body ruled that Mexico did not make an objective examination, based on positive evidence, of the volume and price effects of the dumped imports. The Panel held *Economía* did not rely on "positive evidence"—affirmative, objective, verifiable, or credible data. Rather, *Economía* relied on three unsubstantiated assumptions to reach a finding on volume effects:

- *Price Threshold*: *Economía* assumed rice exported by firms other than the four participants is dumped if it is sold below a certain price level.
- *Market Share Stability*: For 1997 and 1998, *Economía* assumed the subject merchandise from firms other than the four participants held the same share in the total amount of imports of all types of rice from the United States as in 1999.
- *Export Trends*: *Economía* assumed the export volumes from the investigated firms had a similar trend to the export volume of the participant, Farmers Rice, which provided full three-year volume information.

All three assumptions were unsubstantiated. Yet, *Economía* appeared to make these assumptions to affect negatively the interests of the exporters in the case.

Likewise, to reach a finding on price effects, *Economía* relied on unsubstantiated assumptions. *Economía* compared the export price of three distinct types of rice: (1) subject and non-subject merchandise; (2) the export price of Farmers Rice (which had no dumping margin); and (3) the export price of remaining imports (both dumped and non-dumped). From the declines in prices of rice in the first two categories, *Economía* assumed that the price of dumped imports also declined. In other words, the export price of dumped imports follows the same trend as (1) the export price of all types of rice (both subject and non-subject rice) and (2) the export price of a firm, Farmers Rice, which did not dump its product. That assumption was unwarranted, said the Panel. Manifestly, the first category covers non-subject merchandise, and the second category consists of non-dumped rice.

Mexico's appellate argument on the work of *Economía* regarding volume and price effects was unpersuasive. Article 3 of the WTO AD Agreement does not mandate use of a particular methodology, and the Panel did not back its statement (that *Economía* made assumptions to favor the petitioners) with reasoning. The precedent of *Hot Rolled Steel* again was relevant. It defines "positive evidence" to mean evidence that is affirmative, objective, and verifiable in character—and the evidence must be credible. True, the Agreement does not prescribe a methodology. But, the requirement of Article 3.1, as interpreted by

*Hot Rolled Steel*, is clear enough. The unsubstantiated assumptions on which *Economía* relied hardly could be called "positive" evidence. In brief, the Appellate Body easily chose to uphold the Panel's ruling and declare the failure of *Economía* to make reasonable inferences from a credible basis of facts, or to explain their affirmative, objective, and verifiable character.

6. Commentary

a. Voluntary Translation

In the *Cotton* case discussed *infra*, a comment is offered about the translation of WTO Appellate Body Reports. What is not mentioned later, but is worth noting now, is the story of Spanish translation in the *Mexico – Rice* case. The United States and Mexico asked that all written submissions be available in Spanish as well as English. Immediately appreciating the time it would take to implement this request, and that it could not possibly meet the deadline of circulating a Report within ninety days of the Notice of Appeal, the Appellate Body consulted with the two sides. A special working schedule for the appeal was issued comporting with the needs of the WTO Language Services and Documentation Division.[394]

Mexico subsequently requested a modification of the special schedule. It needed more time so as to have an equal opportunity to present its case. Its concern arose because the *Working Procedures for Appellate Review* call for ten to fifteen days between receipt of appellate briefs and the opening day of the oral hearing. Apparently because of the translation of briefs into Spanish as well as English, this period was abbreviated to five days. That is, Mexico feared it might not have enough time to prepare for oral arguments after it got the written submissions.

The very request from Mexico meant the Appellate Body had to again consult the United States, and all third party participants (China, the European Communities, and Turkey), for comment. The American response was it was unclear whether the abbreviated preparation period was "manifestly unfair."[395] But, the United States recognized Mexico's view and acquiesced to a "slight, further modification."[396] The Translation Division responded it could get its work done two days early, which would give Mexico eight days to prepare for the arguments. The point for now? Translation entails trade-offs.

b. A New Fifteen-Month Rule?

394. *See Rice* Appellate Body Report, *supra* note 372, ¶ 7.
395. *See id.* ¶ 10.
396. *See id.*

Did the Appellate Body effectively create a new rule about the permissible gap between a POI and investigation? Arguably, the answer is yes. In its ruling under Article 3.1 of the WTO AD Agreement, the Appellate Body said:

> In the light of the general assessment of these other circumstances carried out by the Panel as trier of the facts, we accept that a gap of [fifteen] months between the end of the period of investigation and the initiation of the investigation, and another gap of almost three years between the end of the period of investigation and the imposition of the final anti-dumping duties, may raise real doubts about the existence of a sufficiently relevant nexus between the data relating to the period of investigation and current injury.[397]

No doubt astute trade lawyers will advise their clients to de-emphasize the first clause. They will urge their clients to regard the rest of the statement as a *de facto* precedent: anything longer than a fifteen-month gap creates a rebuttable presumption that evidence about the injurious effects of dumping is stale.

Thinking in microeconomic terms, this kind of rule may create a positive incentive. It may encourage some national AD authorities to upgrade their capacity to deal effectively with petitions. Put bluntly, a fifteen-month rule could help discourage sloth and ineptitude. In turn, it could help ensure that AD law is not used abusively for protectionist purposes.

### c. Statutory Challenges

As is widely understood, there are three basic kinds of challenges in WTO adjudication: a claim arising out of what happened, a claim arising out of what exists "on the books," and a "hybrid" claim. The first kind is based on facts, and takes aim at the way in which a respondent interpreted and applied its trade measure in a particular context. In a Type I case, the measure itself is not seen as inconsistent with GATT-WTO rules. The second kind is a statutory challenge. Type II may be a preemptive attack, in that the trade measure has not been invoked in the case at bar. Rather, the claim is that the measure itself is incongruous with one or more GATT-WTO requirements. Arguments about the text of the domestic measure are the hallmark of this kind of case. The third kind of claim is a hybrid of the first two types. In a Type III case, the complainant argues that the measure is illegal, and its application to a particular set of facts is disputed, too. All three types of cases can yield important rulings on the meaning of critical terms in GATT-WTO rules.

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397. *Id.* ¶ 167.

Evidently, the *Mexico – Rice* case involved the first kind of challenge, regarding the dumping margin and injury determinations by *Economía*. It also involved statutory challenges by the U.S. to various Mexican trade measures. On various counts, the Panel ruled in favor of the United States, most notably, that:

> ● Article 53 of the FTAM is inconsistent with Article 6.1.1 of the AD Agreement and Article 12:1:1 of the SCM Agreement:[398]
>
> Article 53 obligates interested parties to submit evidence and arguments within twenty-eight working days from the day following publication of initiation of an AD investigation. The Panel said Article 53 violates the rule of Article 6.1.1 of the AD Agreement, and Article 12:1:1 of the SCM Agreement, which prescribe a period of thirty days for any exporter or producer that receives a questionnaire. The Panel chastised Mexico for starting the clock on the date of publication of initiation, because that denies respondents the thirty days to which they are entitled to reply to a questionnaire after they get it. Indeed, exporters or producers sent a questionnaire after the notice of initiation, perhaps because they come forward voluntarily after seeing the notice, are especially prejudiced.

The Appellate Body agreed with the Panel. Essentially, the Appellate Body said that while due process does not extend indefinitely, it does last for a month.

> ●Article 64 of the FTAM is inconsistent with Article 6.8 of the AD Agreement and Paragraphs 1, 3, 5, and 7 of Annex II to this Agreement, and inconsistent with Article 12:7 of the SCM Agreement.[399]

Article 64 says that an AD duty or CVD must be determined on the basis of the highest margin of price discrimination or subsidization, respectively, obtained from facts available, in certain kinds of cases. Those cases include where an exporter or producer does not appear at the investigation, or does not export the subject merchandise during the POI.

The Panel said that Article 64 basically requires indiscriminate application of the highest margin that could be calculated from facts available, even if an exporter does not appear in an investigation because it was not sent a questionnaire, and thus had no idea of the consequences of failure to provide data. The Panel also said that Article 64 does not give discretion to an investigating

398. *See id.* ¶¶ 5(c), 276-283, 350(d)(iii).
399. *See id.* ¶¶ 5(d), 284-298, 350(d)(iv).

authority to use incomplete information that an exporter or producer might provide, and which might lead to a dumping margin lower than the facts-available margin. In other words, in cases of incomplete information provided by a respondent, Article 64 inhibits the authority from using a reasoned selection of the best facts to use in order to piece together the most accurate picture possible. For these reasons, the Panel found that Article 64 violates Article 6.8 of the AD Agreement and Article 12:7 of the SCM Agreement. The Appellate Body agreed with the Panel.

> ●Article 68 of the FTAM is inconsistent with Articles 5.8, 9.3, and 11.2 of the Antidumping Agreement, and with Articles 11:9 and 21:2 of the SCM Agreement.[400]

Article 68 concerns administrative reviews for exporters found in an initial investigation to have a *de minimis* margin. The Panel said that the logical consequence (under Article 5.8) of excluding from an AD order a respondent found not to be dumping above *de minimis* levels is that the respondent may not be subject to an administrative (or changed circumstances) review. That also is true for *de minimis* subsidization levels. The Appellate Body agreed with the Panel, saying that to review such respondents would be to make them subject to the order.

Article 68 also contains a "representativeness" requirement for respondents seeking an administrative review. To obtain an administrative (or changed circumstances) review, a respondent must prove to *Economía* that the volume of its exports to Mexico during the review period is representative. The Panel held that this requirement was inconsistent with Article 9.3.2 of the Agreement. That Article, which deals with AD duties imposed on a prospective basis, in contrast to Article 9.3.1, which concerns retrospective AD assessment and collection, contains no such requirement. Instead, Article 9.3.2 obligates a respondent simply to provide evidence to permit an investigating authority to calculate the dumping margin. Likewise, said the Panel, the Mexican requirement violated Article 11.2 of the AD Agreement, and Article 21:2 of the SCM Agreement. These provisions concern changed circumstances reviews. They do not contain an Article 68-style requirement. Rather, they instruct a respondent to (1) ensure that a reasonable period of time has elapsed since the AD duty or CVD was imposed, and (2) substantiate its request for a review with positive information. If the respondent does so, then a review is required, and the respondent can do so without submitting data on export volumes.

On appeal, Mexico argued that none of the provisions in the AD or SCM Agreements forbid it from conditioning a review on showing representative export volumes. Upholding the Panel, the Appellate Body rejected this argument. Even if the provisions do not forbid the requirement, it does not mean they permit it.

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400. *See Rice* Appellate Body Report, *supra* note 372, ¶¶ 5(e), 299-316, 350(d)(v).

Finally, the Panel also found that Articles 68 and 97 of the FTAM, read together, are inconsistent with Articles 9.3.2 and 11.2 of the AD Agreement, and Article 21:2 of the SCM Agreement.[401] On appeal, Mexico contended that the United States failed to make a *prima facie* case that its laws were inconsistent with the Agreements, and contested the interpretation of the Panel of these Agreements.

The Appellate Body rejected Mexico's arguments. Like the Panel, the Appellate Body held that under Articles 11.2 and 12.2.2 of the AD Agreement, and Articles 21:2 and 22:5 of the SCM Agreement, an AD duty or CVD is definitive (as opposed to provisional) when it is imposed following a final affirmative determination (as opposed to a preliminary affirmative determination). At that point, subject merchandise is subject to an AD or CVD order. The problem with the Mexican rules is they suggest that a duty is not definitive until all judicial review possibilities are exhausted. That is, Articles 68 and 97 preclude *Economía* from conducting reviews subject to judicial proceedings, including panel hearings under Chapter 19 of the North American Free Trade Agreement (NAFTA). Thus, the Mexican rules impose a condition (completing judicial proceedings) on annual duty assessment and changed circumstances reviews that does not exit in the AD or SCM Agreements.

- Article 89D of the FTAM is inconsistent with Article 9.5 of the AD Agreement and Article 19:3 of the SCM Agreement.[402]

Article 89D says that producers of goods subject to a CVD that have not exported the subject merchandise during the POI may ask *Economía* to initiate a procedure for new exporters with a view to assessing individual subsidization rates. However, the producer must show that the volume of its exports, following the POI, of goods subject to the CVD was "representative" for the period of review. In brief, Article 89D is a "new shipper rule" for an expedited review, but with a "representativeness" requirement.

The Panel held that the requirement restricts the right of the producer to an expedited review, in violation of Article 9:5 of the AD Agreement and Article 19:3 of the SCM Agreement. Article 9:5 of the AD Agreement obligates an investigating authority to conduct an expedited review for a new shipper if the requesting producer or exporter (1) did not export the subject merchandise during the POI, and (2) is not related to a producer or exporter that already is subject to the AD duty in question. Similarly, Article 19:3 of the SCM Agreement requires

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401. *See id.* ¶¶ 5(h), 331-349, 350(d)(viii). Article 68 mandates an annual review, upon request of a party, of a final or definitive CVD, and of producers for which no positive dumping margin or subsidization was found. Article 97 states any interested party may choose to resort to an alternative dispute settlement mechanism, but if none is chosen, then only the resolution issued by *Economía* shall be considered final.

402. *See id.* ¶¶ 5(f), 317-324, 317-324, 350(d)(vi).

an authority to conduct an expedited review for a new shipper, upon request, if the shipper shows (1) it is not subject to a CVD, and (2) was not examined during the original investigation for reasons other than refusal to cooperate. The requirement in Article 89D of the FTAM compels *Economía* to reject a review request if the new shipper fails to show representativeness. Therefore, the requirement is an additional ground for denial of a request, i.e., one beyond the permissible bases under the AD and SCM Agreements.

On appeal, Mexico argued inferentially from the silence of these Agreements as to whether an investigating authority may consider representativeness of export volumes. From this silence, Mexico inferred it was the deliberate intention of the Uruguay Round negotiators to allow an authority to implement expedited reviews for new shippers in the way best-suited to the particular AD or CVD system in a WTO Member. In other words, Mexico argued that silence must be given meaning. Not so, responded the Appellate Body, applying the same logic as it had with respect to Article 68 of the FTAM. It upheld the Panel.

Accordingly, *Mexico – Rice* is a Type III case. As indicated above, Mexico unsuccessfully appealed all four findings.[403]

## III. AGRICULTURE

### A. Domestic Support, Export Subsidies, and Cotton

#### 1. Citation

*United States – Subsidies on Upland Cotton*, WT/DS267/AB/R (issued March 3, 2005, adopted March 21, 2005) (complaint by Brazil).

#### 2. Facts and Panel Holdings

##### a. Understanding the Disputed Cotton Subsidies[404]

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403. *See id.* ¶¶ 132(d)(iii), 350(d)(iii) (concerning FTAM Article 53), 132(d)(iv), 350(d)(iv) (concerning FTAM Article 64), 132(d)(v), 350(d)(v) (concerning FTAM Article 68), 132(d)(vi), 350(d)(vi) (concerning FTAM Article 89D), 132(d)(viii), 350(d)(viii) (concerning FTAM Articles 68 and 97).

404. This discussion draws from Appellate Body Report, *United States – Subsidies on Upland Cotton*, WT/DS267/AB/R, ¶¶ 1-9, 251, 303, 311-312, 359 nn.368 & 370, 385-86, 513-17, 536-37, 586-89 (Mar. 3, 2005) [hereinafter *Cotton* Appellate Body Report].

Throughout this discussion, the term "cotton" refers to "upland cotton." As Brazil indicated in its request for establishment of a panel, "upland cotton" means "raw upland cotton as well as the primary processed forms of such cotton including upland cotton lint and cottonseed." That is, "upland cotton" covers (1) raw cotton and (2) cotton

Discussing the facts and Panel rulings, as below, is ethereal without an understanding of each of the American domestic support measures Brazil challenged. The mechanics of these programs are explained below. The U.S. Department of Agriculture (USDA) administers all federal commodity subsidy programs.[405]

Specifically, the Commodity Credit Corporation Charter Act of 1948 created the CCC, and gave the Secretary of Agriculture broad authority to implement commodity programs that supported prices by making loans, payments, or purchases, and by engaging in other transactions. The CCC, which is a wholly-owned government corporation within the USDA, has no staff, but functions as a financing institution for all USDA farm price and income support programs, as well as for support of agricultural exports. Accordingly, the CCC has the authority to buy, sell, lend, make payments, and take part in other activities to:

(1) increase production;
(2) stabilize prices;
(3) assure adequate supplies; or
(4) facilitate efficient marketing of agricultural products.

Most subsidy programs funded through the CCC are administered by employees of the Farm Service Agency (FSA).

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that has undergone primary processing, such as cottonseed, but does not include extra long staple (ELS) cotton. *See* Panel Report, *United States – Subsidies on Upland Cotton*, WT/DS267/R, ¶ 7.207 (Sep. 8, 2004) [hereinafter *Cotton* Panel Report]. "Cottonseed" is the seed from any variety of cotton, whether upland cotton or ELS produced in the United States.

Thus, "cotton" and "upland cotton" are technically not synonymous. However, approximately ninety-seven per cent of the annual U.S. cotton crop is from upland cotton, i.e., upland cotton accounts for about ninety-seven per cent of U.S. cotton output. *See id.* ¶¶ 7.207, .580, .586 n.682.

For a treatment of the cotton dispute, see Kevin C. Kennedy, *The Incoherence of Agricultural, Trade, and Development Policy for Sub-Saharan Africa: Sowing the Seeds of False Hope for Sub-Saharan Africa's Cotton Farmer?*, 14 KAN. J.L. & PUB. POL'Y 307-88 (Winter 2005). For a treatment of possible argumentation upon expiry of the Peace Clause, see Richard H. Steinberg & Timothy E. Josling, *When the Peace Ends: The Vulnerability of EC and U.S. Agricultural Subsidies to WTO Legal Challenge*, 6 J. INT'L ECON. L. 369-417 (July 2003).

405. *See Cotton* Panel Report, *supra* note 404, ¶ 7.270. *See generally* GEOFFREY S. BECKER, FARM COMMODITY PROGRAMS: A SHORT PRIMER (2005) *available at* http://ncseonline.org/nle/crsreports/05Feb/RS20848.pdf.

### i. Cottonseed Payments[406]

Cottonseed Payments are *ad hoc* emergency and supplementary assistance given to a first handler or producer of cottonseed. (A "first handler," or "first-time handler," is a gin, i.e., a person or entity that removes cottonseed from cotton lint.) These payments were made pursuant to the Agricultural Risk Protection Act of 2000 (ARP Act of 2000),[407] and the Crop Year 2001 Agricultural Economic Assistance Act (2001 Act),[408] to offset low commodity prices. They were made only for cottonseed produced and ginned in the United States. These two Acts appropriated a specific amount of money for the 2000 crop of cottonseed, i.e., marketing year (MY) 2000, specifically, $100 million (under the ARP Act of 2000), and supplemental assistance of $84.7 million (under the 2001 Act), respectively.[409]

Accordingly, the total amount of Cottonseed Payments for MY 2000 was $184.7 million.[410] The legislation specified a payment rate in dollars per ton, and this rate was computed by dividing the total available funds by the total payment quantity of 2000 crop cottonseed of first handlers who applied to participate. Payments were made to first-time handlers, because they usually retained proceeds from cottonseed sales. As a condition of getting payment, a first handler had to share the payment with producers to the extent that the revenue from the sale of cottonseed was shared with the producer. Thus, while the payments went to first handlers, to some extent they benefited producers of cotton.

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406. The *Cotton* Appellate Body Report does not contain a good description of Cottonseed Payments. *See Cotton* Appellate Body Report, *supra* note 404. The discussion of them herein draws from *Cotton* Panel Report, *supra* note 404, ¶¶ 7.205-.212, .301-.303, .580, .639, .1215.

407. Agricultural Risk Protection Act of 2000, Pub. Law No. 106-224, 114 Stat 358 (codified as amended at 7 U.S.C. § 1421 (2000)). *See especially* Section 204(e) thereof.

408. Emergency Agricultural Assistance Act of 2001, Pub. L. No. 107-25, 115 Stat. 201 (2001). *See especially* Section 6 thereof. In the *Cotton* case, the United States explained the short title as enacted of Public Law 107-25 is the Emergency Agricultural Assistance Act, but the short title as introduced in August 2001 in Congress was the Crop Year 2001 Agricultural Economic Assistance Act.

409. The United States has provided cottonseed subsidies in years other than 2000, such as 1999 and 2002. The Panel ruled payments for only the 2000 crop were within its terms of reference. *See Cotton* Panel Report, *supra* note 404, § VII:B.

410. Cottonseed Payments were as follows: MY 1999: $79 million; MY 2000: $184.7 million; and MY 2002: $50 million. All but the statute authorizing cottonseed payments for the 1999 crop appropriated a specific amount for cottonseed support. Brazil and the United States disagreed over whether Cottonseed Payments should be included in the measurement of U.S. support. The Panel held that all Cottonseed Payments for 1999-2002 must be included in this measurement for purposes of the Article 13 Peace Clause in the Agreement on Agriculture. *See Cotton* Panel Report, *supra* note 404, § VII:4. As discussed below in the context of Article 13(b) and non-Green Box measures, the Appellate Body agreed.

### ii. Counter-Cyclical Payments

Counter-Cyclical Payments are a means of income support to farmers of certain crops (called "covered commodities"). They supplement Direct Payments and Marketing Loan Program Payments. Specifically, Counter-Cyclical Payments fill a gap between (1) the market price (plus any Direct Payment or Marketing Loan Program Payment) and (2) a government-established target price. For cotton, the target price is 72.4 cents per pound. The eligibility requirements and planting flexibility limitations for Counter-Cyclical Payments are the same as those for Direct Payments. As with Direct Payments, the amount of Counter-Cyclical Payments depends on base acres. Like Direct Payments, Market Loss Assistance Payments, and Production Flexibility Contract Payments, Counter-Cyclical Payments did not exist in 1992, the base year for measuring bound levels of support in the Peace Clause of Article 13(b) of the Agreement on Agriculture.

### iii. Crop Insurance Payments[411]

Crop insurance is a long-standing feature of U.S. commodity support dating to the era of the Dust Bowl and New Deal. Crop insurance subsidies are available for most crops, though they are not generally available for the entire agricultural sector in all areas of the United States.[412] That is, the subsidy is not

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411. The *Cotton* Appellate Body Report does not contain a good description of Crop Insurance Payments. *See Cotton* Appellate Body Report, *supra* note 404. The discussion of them herein draws from *Cotton* Panel Report, *supra* note 404, ¶¶ 7.227-.232, .250(v).

412. Regarding eligibility for a crop insurance subsidy, the Federal Crop Insurance Act (discussed above) defines (in Section 518) the "agricultural commodities" to which it applies, and thereby delineates the subject matter covered by insurance policies that are subsidized under the Act. Federal Crop Insurance Act, 7 U.S.C. § 1518 (2005). They are predominantly crops, not livestock. *Id.* The definition expressly excludes "stored grain." The definition includes, *inter alia*, cotton and other U.S. crops. *Id.* Livestock (while not expressly enumerated) falls under the blanket reference to "any other agricultural commodity." *Id.*

However, the Act contains "Livestock Pilot Programs," such as the Adjusted Gross Revenue (AGR) Program and the "AGR-Lite" Program. *Id.* § 1523. Such Programs offer insurance protection against losses involving, *inter alia*, livestock poisoning and disease. *Id.* The livestock eligible for these Programs include, but are not limited to, cattle, goats, poultry, sheep, and swine. Federal Crop Insurance Act, 7 U.S.C. § 1523. Under the Programs, the FCIC pays a percentage of the insurance premium and administrative fee with respect to certain policies for some livestock production in limited areas of the United States. *Id.* That is, these Programs are not universally available for all livestock in the United States. The AGR Program complements other Federal crop insurance plans. *Id.* When a producer purchases both AGR and other crop insurance plans, the AGR premium is reduced. *Id.* To qualify, a producer must earn no more than thirty-five percent of expected allowable income from animals and animal products. *Id.*

universally available for all agricultural production—no subsidized crop insurance policies are available to all agricultural producers. Rather, the subsidy is generally limited to certain crops, differentiates among such crops, and, for livestock, is only available in certain regional pilot programs.[413]

The basic authorizing legislation is the Federal Crop Insurance Act (FCI Act), which is Title V of the Agricultural Adjustment Act of 1938.[414] The FCI Act empowers the USDA—specifically, the Secretary of Agriculture—to provide crop insurance and reinsurance. From time to time, Congress amends the FCI Act, with two major changes in the Federal Crop Insurance Reform Act of 1994 and the ARP Act of 2000. Federal crop insurance is administered by the Federal Crop Insurance Corporation (FCIC), an agency within the USDA. The Risk Management Agency (RMA), an independent office within the USDA, supervises crop insurance matters.

Accordingly, the FCIC offers annual crop yield or revenue insurance coverage to producers of cotton, as well as other crops, for losses caused by natural disasters and market fluctuations. It also offers reinsurance to providers of such insurance. The underlying policy objective is a sound system of crop insurance to promote national welfare by improving the economic stability of agriculture. In general, the FCIC may insure, or provide reinsurance for, insurers of producers of agricultural commodities grown in the United States under an insurance plan adapted to the commodity in question. To qualify for insurance coverage, losses of the insured commodity must be due to drought, flood, or other natural disaster, with the Secretary of Agriculture responsible for this determination. Beginning with the 2001 crop, additional, "Special Provisions for Cotton and Rice," apply. Under them, the FCIC offers insurance plans, including prevented planting coverage and replanting coverage, to cover losses of cotton (both upland and ELS cotton) and rice, resulting from failure of irrigation water supplies, which in turn occurred because of drought and saltwater intrusion.

The major type of insurance plan, which concerns Actual Production History, is available for approximately 100 agricultural commodities and specifies cotton (namely, upland cotton) as one of them. There are four other types of insurance plan—Group Risk, Crop Revenue Coverage, Income Protection, and Revenue Assurance. These other types are available only for a limited number of commodities (eight commodities or fewer), but cotton is one such commodity.

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413. Given these facts, the *Cotton* Panel said it need not address the U.S. argument that the crop insurance subsidy is generally available to the American agricultural sector as a whole, and thus, would not be specific within the meaning of Article 2 of the SCM Agreement. As the Panel observed, the crop insurance subsidy is not, in fact, generally available to the agricultural industry. The Panel also stated that this industry, represented by a portion of U.S. farmers who grow and produce certain agricultural crops (and certain livestock in certain regions under restricted conditions), is a sufficiently discrete segment of the American economy in order to qualify as "specific" within the meaning of Article 2 of the SCM Agreement. *Cotton* Panel Report, *supra* note 404.

414. *See* 7 U.S.C. § 1501-24.

Regardless of the plan, and as set out in each plan, the FCIC bears a proportion of the premium borne. The USDA keeps separate accounts on the amount of premiums the FCIC pays for each crop, including an account specific to cotton.

U.S. crop insurance legislation also contains provisions on catastrophic risk protection and additional—or buy-up—coverage. The FCIC crop insurance plans include protection against losses resulting from low crop yields and protection against low revenue (regardless of whether the low revenue results from low yields or low crop prices). For catastrophic risk insurance, the coverage level is fifty percent of yield (indemnified at fifty-five percent of expected price for the 1999 and subsequent crop years). A producer pays none of the premium for catastrophic coverage (though an administrative fee, up to a maximum of $100, is payable per crop per county, which can be waived for limited-resource farmers). For buy-up insurance, the coverage level is higher, namely, up to seventy-five (or in some cases, eighty-five) percent of expected yield or revenue. A producer pays a portion of the premium, and the FCIC pays the balance of the premium. (The FCI Act sets out a formula for the amount of the premium the FCIC pays.) For reinsurance, the FCIC offers insurance to an insurance provider, thereby covering underwriting costs, and the FCIC defrays some of its own administrative costs.

Most farmers apply for an FCIC crop insurance policy before planting, but pay their share of the insurance premium after harvest. Insurance providers approved by the U.S. government sell these policies. The price a farmer pays is the total premium minus the amount the FCIC pays. The portion of the premium the FCIC pays depends on the level of coverage and the features of the policy. But, the FCIC portion is the same for all crops covered by a particular insurance plan.[415] The ARP Act of 2000 increased the portion of the premium the FCIC pays (commencing in the 2001 crop year). For the 2002 crop year, over ninety percent of the cotton area covered by federal crop insurance was insured at a coverage level of seventy percent or less of expected yield or revenue. The FCIC paid a portion of the premium.

### iv. Direct Payments

Direct Payments replaced Production Flexibility Contract Payments (discussed below), but the nature of the schemes was largely the same. Direct Payments were introduced by the Farm Security and Rural Investment Act of 2002 (also called the FSRI Act of 2002, or 2002 Farm Bill), and applied to the

415. Emergency premium discounts sometimes are available, which further reduce producer costs of buy-up coverage. For example, in 1999 and 2000, respectively, emergency discounting at rates of thirty percent and twenty-five percent occurred. *Cotton* Appellate Body Report, *supra* note 404, ¶¶ 73-74, 116, 124, 127-128, 186, 249(e)(iii), 300, 303-307, 591, 593, 646-648, 655-656, 658-672, 721, and 730.

MY 2002-07.[416] (For the 2002 crop, farmers were eligible for both kinds of Payment, but any Production Flexibility Contract Payment received was deducted from a Direct Payment.) Like the amount of Production Flexibility Contract Payments, the amount of Direct Payments to which a farmer was entitled depended on base acreage, i.e., historical production of cotton during certain base periods. The rate of Direct Payments was fixed for MY 2002-07 at 6.67 cents per pound. Entitlement to Direct Payments, as to Production Flexibility Contract Payments, did not depend on a farmer growing cotton or any particular crop, and the farmer could opt to let the land lie fallow. But, importantly, the Direct Payment Program, like its predecessor, had a planting flexibility limitation. The United States would cut or eliminate payments if the farmer grew fruits or vegetables (other than dry peas, lentils, mung beans, and—under the Direct Payment scheme—wild rice).

#### v. Export Credit Guarantees under the GSM 102, GSM 103, and SCGP Schemes[417]

The United States has had Export Credit Guarantee programs since 1980. Brazil challenged—with success—these measures as illegal Red Light export subsidies under Article 3:1(a) of the SCM Agreement. In particular, it attacked three measures—the General Sales Manager (GSM) 102 and 103 Programs, and the Supplier Credit Guarantee Program (SCGP).[418] The USDA administers export credit guarantee programmes for commercial financing of U.S. agricultural commodities through the CCC.

By statute, the CCC "shall finance or guarantee . . . only United States agricultural commodities."[419] The statute also sets out percentages of the total amount of export credit guarantees issued for certain fiscal years that promote the export of processed or high-value farm products.[420] The balance of the guarantees is issued to promote the export of bulk or raw agricultural commodities. The CCC operates the three Export Credit Guarantee Programs Brazil challenged, GSM 102, GSM 103, and the SCGP.[421]

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416. A MY follows the cycle of harvesting crops in the fall and planting them in the spring. Thus, a MY can run from 1 August to 31 July. Farm Security and Rural Investment Act of 2002, Public Law 107-171, 116 Stat. 134.

417. The *Cotton* Appellate Body Report does not contain a good description of Export Credit Guarantees. *See Cotton* Appellate Body Report, *supra* note 404. The discussion of them herein draws from *Cotton* Panel Report, *supra* note 404, ¶¶ 7.304-.312.

418. These Programs are established by 7 U.S.C. § 5622 (2002).

419. *Id.* § 5622(h).

420. *See Id.* § 5622(k). The percentage requirements apply to the extent a reduction in the total amount of guarantees issued is not required to meet it.

421. Brazil did not challenge the CCC Facility Guarantee Program. *Cotton* Panel Report, *supra* note 404, ¶ 3.1(i).

The stated purpose of these Programs indicates the CCC may use export credit guarantees to "increase exports of agricultural commodities;" "to compete against foreign agricultural exports;" "to assist countries in meeting their food and fiber needs . . . ;" and "for such other purposes as the Secretary [of Agriculture] determines appropriate . . . ."[422] The statute authorizes the CCC to engage in the following transactions in a manner to benefit directly U.S. agricultural producers:

> (1) Under the GSM 102 Program, guarantee repayment of credit made available to finance commercial export sales of U.S. agricultural commodities on credit terms of between [ninety] days and three years.
>
> Specifically, the CCC is authorized to guarantee repayment of credit made available to finance commercial export sales of agricultural commodities from privately owned stocks on credit terms between ninety days and three years. Generally, the CCC covers ninety-eight percent of the principal and a portion of the interest. The CCC selects the commodities according to market potential. The CCC does not provide financing to foreign banks, but rather guarantees payments due from those banks. Only foreign banks approved by the CCC are eligible for guarantees.
>
> To obtain a payment guarantee, once a firm export sale contract is reached, the U.S. exporter applies for a guarantee, and must do so before the date of exportation. The exporter pays a fee that depends on the dollar amount guaranteed, with the relationship between fees and dollar amounts determined according to a schedule of rates applicable to different credit periods. There is a statutory cap on the fee charged of [one] percent of the guaranteed dollar value of the transaction.[423]
>
> Financing occurs when a CCC-approved foreign bank issues an irrevocable letter of credit in favor of the U.S. exporter. Ordinarily, this letter of credit is advised or confirmed by a financial institution in the United States that agrees to extend credit to the foreign bank. If the foreign bank fails to make any payment as agreed, then the exporter submits a notice of default to the CCC. The CCC pays the exporter on a valid claim for loss.

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422. 7 U.S.C. § 5622(d).

423. Section 211(b)(2) of the Agricultural Trade Act of 1978 limits the fee of GSM 102 Program transactions. 7 U.S.C. § 5641(b)(2) (2000). This limit does not apply to transactions under the CCC Facility Guarantee Program.

(2) Under the GSM 103 Program, guarantee repayment of credit made available by financial institutions in the United States to finance commercial export sales of agricultural commodities on credit terms of between three and ten years.

Operation of the GSM Program 103 is similar to the GSM 102 Program. There are three main differences. First, GSM 103 guarantees are "intermediate term credit guarantees," issued for terms from three to [ten] years.[424] Second, the CCC must make additional determinations when issuing a GSM 103 export credit guarantee. In particular, the statute states the CCC

> shall not guarantee . . . the repayment of credit made available to finance an export sale unless the Secretary [of Agriculture] determines such sale will: (1) develop, expand or maintain the importing country as a foreign market, on a long-term basis, for the commercial sale and export of United States agricultural commodities, without displacing normal commercial sales; (2) improve the capability of the importing country to purchase and use, on a long-term basis, United States agricultural commodities; or (3) otherwise promote the export of United States agricultural commodities.[425]

Third, there is no statutory cap on the origination fees the CCC may charge in connection with a GSM 103 guarantee.

(3) Under the SCGP, the CCC issues guarantees to repay credit made available for a period not exceeding 180 days, where a U.S. exporter extended credit to a buyer located in a foreign country that purchased an American agricultural commodity. In other words, the exporter negotiates terms of a credit sale with the importer of the commodity. To be eligible for a CCC guarantee, the credit must be secured by a promissory note signed by the importer. That means the importer must issue a dollar-denominated promissory note in favor of the U.S. exporter.[426] The exporter may negotiate an arrangement to be paid, in full or in part, by assigning the right to proceeds that

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424. 7 U.S.C. § 5641(b).

425. 7 U.S.C. § 5622(c). The reference to "a long-term basis" does not apply to determinations regarding sales to the independent states of the former Soviet Union. Additional criteria for determinations to be made relating to GSM 103 are set out in *id.* § 5622(f)(2).

426. CCC announcements for countries and regions specify the form the promissory note must take. *Cotton* Appellate Body Report, *supra* note 404, ¶ 591.

> may become payable under the CCC guarantee to a U.S. financial institution.
>
> As with the GSM 102 and 103 Programs, under the SCGP, the CCC does not provide financing. Rather, the CCC guarantees payment due from the importer. Typically, the CCC guarantees a portion (sixty-five percent) of the value of the exports. The guarantee covers principal, but not interest. Once a firm export sale contract exists, the U.S. exporter applies for a payment guarantee, and must do so before the date of exportation. The exporter pays a fee for the guarantee calculated on the guaranteed portion of the value of the export sales. Like the GSM 102 Program, in the SCGP, there is a statutory cap on the fee charged of [one] percent of the guaranteed dollar value of the transaction.[427] If payment is not made on the promissory note, then the exporter (or assignee) submits a notice of default to the CCC. The CCC pays a valid claim for loss.

By statute, the CCC "shall make available" for each relevant fiscal year "not less than $5,500,000,000 in credit guarantees" under these three Export Credit Guarantee Programs.[428] The CCC retains discretion to allocate the guarantees between short and intermediate terms, and to impose "such terms and conditions as the [CCC] determines to be necessary."[429]

The statute also sets out restrictions on the use of credit guarantees. Overall, "the CCC shall not make credit guarantees available in connection with sales of agricultural commodities to any country that the Secretary [of Agriculture] determines cannot adequately service the debt associated with such sale."[430] Countries eligible for any of the CCC Export Credit Guarantee Program are categorized according to risk. The risk premium of the country has no impact on the premiums payable under a Program.

#### vi. Market Loss Assistance Payments

This measure provided *ad hoc* annual payments to farmers between 1998 and 2001, who also received Production Flexibility Contract Payments. The eligibility criteria for the two types of measures essentially were the same. Market Loss Assistance Payments were designed to be additional help to farmers to make up for losses caused by low commodity prices. Each payment was made pursuant

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427. The Agricultural Trade Act of 1978 limits the fee of transactions to this level. 7 U.S.C. § 5641(b)(2).

428. *Id.* § 5641(b)(1).

429. 7 U.S.C. § 5622(g).

430. *Id.* § 5622(f).

to separate legislation, the last of which was enacted on 13 August 2001 and covered the MY 2001 (i.e., 1 August 2001 to 31 July 2002). A Marketing Loss Assistance Payment was proportionate to the amount of a Production Flexibility Contract Payment, with the actual amount depending on how much was deemed allocated as a Marketing Loss Assistance Payment. Marketing Loss Assistance Payments, along with Production Flexibility Contract Payments, were the only two disputed subsidy measures in the *Cotton* case that had expired at the time the terms of reference of the Panel were established.

#### vii. Marketing Loan Program Payments

Support under the Marketing Loan Program could take one of a variety of forms. However, common to all forms was that payments to farmers depended on the difference between the (1) adjusted world price for cotton, which is a reference price tied to the market price of cotton, and (2)the so-called "loan rate" fixed periodically under the Program.

#### viii. Production Flexibility Contract Payments (Deficiency Payments)

This measure provided income support to farmers. It was established by the Federal Agricultural Improvement and Reform Act of 1996 (also called the FAIR Act of 1996 or 1996 Farm Bill) for MY 1996-2002. They were discontinued in May 2002 by the Farm Security and Rural Investment Act of 2002 (the FSRI Act of 2002, or 2002 Farm Bill), and replaced by Direct Payments. The United States made payments to farmers who had produced historically one (or more) of seven eligible commodities, one of which was cotton. A historical producer would enroll acres on which it had grown cotton during a base period. The United States then would allocate to this producer base acres, and a farm-specific yield per acre. The producer would receive a payment dependent on base acreage and yield per acre at a rate specified annually.

The producer was not required to grow cotton to obtain payments. Rather, the United States provided support regardless of what the producer chose to grow, or even if the producer opted not to grow any crop. Significantly, however, there was a limitation on this planting flexibility. The United States would reduce or eliminate payments if the producer grew fruits or vegetables (other than dry peas, lentils, and mung beans).

Production Flexibility Contract Payments replaced Deficiency Payments. The latter support measure was created by the Food, Agriculture, Conservation and Trade Act of 1990 (the FACT Act of 1990, also called the 1990 Farm Bill). Deficiency Payments were relevant to calculation of the 1992 level of support, a benchmark under the Agreement on Agriculture. Essentially, a Deficiency

Payment for cotton depended on the gap between (1) the national average market price for cotton, or the loan rate under the Marketing Loan Program, whichever was higher, and (2) a target price of 72.9 cents per pound of cotton. Whenever the market price or loan rate fell below the target price, a Deficiency Payment would fill the deficit.

ix. User Marketing Payments, also called Step 2 Payments

The United States has maintained Step 2 Payment schemes since 1990. Successive legislation, such as the FAIR Act of 1996, and Section 1207(a) of the FSRI Act of 2002, authorized these schemes.[431] The funds provided are available to both users and exporters of American cotton. In the *Cotton* case, Brazil successfully challenged Step 2 Payments to users as illegal Yellow Light subsidies causing serious prejudice (namely, price depression) under Articles 5-6 of the SCM Agreement, and illegal Red Light import substitution subsidies under Article 3:1(b) of that Agreement. (Significantly, in February 2006, to comply with the Appellate Body ruling, and to deliver on a promise the USTR made at the December 2005 Hong Kong Ministerial Conference, the House of Representatives agreed to eliminate Step 2 payments. The Senate approved the elimination in late 2005.)

Essentially, the CCC issues marketing certificates or cash payments—collectively called "user marketing payments," or simply "Step 2 Payments"—to eligible domestic users and exporters of cotton when certain market conditions exist. Those conditions relate to pricing, namely, when benchmarks for U.S. cotton pricing are exceeded. The cotton must be "eligible," i.e., domestically produced and baled, and the bale must be opened by an "eligible domestic user" or exported by an "eligible exporter." An "eligible domestic user" of cotton is a person regularly engaged in the business of opening bales of eligible cotton to manufacture the cotton into cotton products in the United States, and who has an agreement with the CCC to participate in the Step 2 Payment program. Textile mills are quintessential examples of domestic users. An "eligible exporter" of cotton is a person, including a producer or cooperative marketing association) who regularly sells eligible cotton for export from the United States, and who has an agreement with the CCC to participate in the program.

Regarding the market conditions in which Step 2 Payments are made, domestic users must have bought for manufacturing use, or exporters must have sold for export, cotton (that is, eligible cotton) in a week following a four-week period when two price conditions are met. The two price conditions (below) amount to a requirement that the price of U.S. cotton was higher than in Europe,

431. Farm Security and Rural Investment Act of 2002, Pub. L. No. 107-171 § 1207(a), 116 Stat. 134, 161 (2002).

and the world market price for cotton was lower than a U.S.-set target. In turn, if these requirements are met, then a Step 2 Payment ensures U.S. cotton is price competitive vis-à-vis foreign cotton, because the Payment captures the differential between the (lower) prevailing foreign and (higher) U.S. cotton prices.

Each price condition may be expressed arithmetically. The first price condition, which was used for 1996-2001, was:

| | | | | |
|---|---|---|---|---|
| Lowest U.S. Price Quote for Cotton Delivered to Northern Europe | – | Northern Europe Price Quote | > | 1.25 cents per pound |

The condition is satisfied if the U.S. cotton price exceeds the Northern European price by more than 1.25 cents per pound. For 2002-05, this price condition was relaxed by eliminating the 1.25 cents per pound threshold. That is, the right-hand side term was zero, meaning this condition was met whenever the U.S. cotton price was higher than the European price, i.e., whenever U.S. cotton was relatively more expensive by any amount. Intuitively, the condition is designed to encourage buying of American cotton when it would not be economically rational to do so, namely, when American cotton is more expensive than non-U.S. substitutes.

Arithmetically, the second price condition is:

Adjusted World ≤ (Market Loan Rate) x 130 percent Price of Cotton

This condition occurs when the world cotton price is at or below a threshold defined by the Market Loan Rate, a target price set by the U.S. Government. Under the FAIR Act of 1996, for 1996-2001, the threshold was 130% of the Market Loan Rate. Under the FSRI Act of 2002, for 2002-05, this price condition was tightened slightly, by raising the threshold to 134% of the Rate. Intuitively, the second condition says the world market price is low when it is not more than about one-third above the U.S. target price. If this condition exists, then it suggests it would be economically rational for domestic users, users elsewhere, and exporters to purchase cotton on the world market—not from U.S. cotton farmers. When the second condition is met, that suggestion is strengthened.

Taken together, the two conditions, if met, mean it is economically rational for a user or exporter to buy cotton quoted in Northern Europe, or on the world market, rather than the relatively more expensive U.S. grown cotton. Herein lies why the two conditions are triggers for a Step 2 Payment. If the conditions exist, then a Step 2 Payment counteracts them, making it financially viable to buy American cotton. What is the amount of this Payment? Between 1996-2001 (and again starting 1 August 2006), it was the difference between the two price quotes during the fourth week of the four-week period in which the two price conditions are met, i.e., the difference between the U.S. Price and the

Northern European Price, minus the 1.25 cents per pound threshold. From 2002-05, it was the difference between the two Prices, with no threshold subtracted.

As the above explanation intimates, the *Cotton* case is fact-intensive. With an appreciation for these U.S. domestic support and export measures, it is possible to see the sophisticated argumentation in the *Cotton* case. In particular, the way in which Brazil carefully formulated its claims in anticipation of generally robust American defenses, and the considerable extent to which Brazil was successful, become evident. Another way to put this point is Brazil showed that a major developing country can master complicated facts and apply technical rules to them, redolent of India in the *Bed Linens* case. Consequently, while least developed countries remain severely challenged in WTO adjudication, that comment—following smart performances by Brazil and India—is an increasingly empty cry with respect to developing countries.

#### b. U.S. Domestic Support and the Interaction of the Peace Clause and Yellow Light Subsidies[432]

Ironic in rubric but not at law, the starting point in the battle between Brazil and the United States over cotton subsidies is the Peace Clause.[433] This

432. This discussion draws from *Cotton* Appellate Body Report, *supra* note 404, ¶¶ 1-9, 251, 303, 313.

433. The Appellate Body adjudicated the following procedural issues, which are not treated herein:

> (1) Terms of Reference of the Panel concerning Expired Measures:
>
> Whether Articles 4:2 and 6:2 of the DSU exclude expired measures from the potential scope of consultations or a request for establishment of a panel and, therefore, whether Production Flexibility Contract Payments and Market Loss Assistance Payments were outside the terms of reference of the *Cotton* Panel. The Panel responded in the negative, i.e., the DSU did not exclude these measures, and were within its terms of reference. The Appellate Body agreed with the Panel. The Appellate Body also held the Panel met its responsibilities under DSU Article 12:7 to set out findings of fact, the applicability of relevant provisions, and the basic rationale in support of a finding. *See id.* ¶¶ 249(a)(i), 250-277, 763(a)(i).
>
> (2) Terms of Reference of the Panel with respect to Export Credit Guarantees:
>
> Whether Export Credit Guarantees for eligible U.S. agricultural commodities other than cotton were within the terms of reference of the Panel. The Panel ruled in the affirmative, saying its terms covered Export Credit Guarantees relating to all eligible products. The Appellate Body upheld the Panel's ruling. *See id.* ¶¶ 249(a)(ii), 278-294, 763(a)(ii).

Clause, formally entitled "Due Restraint" and set in Article 13 of the Agreement on Agriculture, protects three kinds of farm subsidies from claims they are unlawful, where such claims otherwise could be brought under the SCM Agreement. This Article, entitled "Due Restraint," states:

> During the implementation period [i.e., from 1 January 1995 until 31 December 2003], 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* [which contains criteria for the Green Box] shall be:
>
> (i) non-actionable subsidies for purposes of countervailing duties;
>
> (ii) exempt from actions based on Article XVI

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(3) Statement of Available Evidence concerning Export Credit Guarantees:

Whether Brazil provided a so-called "Statement of Available Evidence" with respect to this measure as required by Article 4:2 of the SCM Agreement. Both the Panel and Appellate Body agreed Brazil had done so. *See id.* ¶¶ 249(a)(ii), 295-309, 763(a)(ii).

(4) Serious Prejudice and Price-Contingent Subsidies:

As regards Counter-Cyclical Payments, Market Loss Assistance Payments, Marketing Loan Program Payments, and Step 2 Payments—the "Price-Contingent Subsidies"—whether the Panel discharged its responsibilities under Article 12:7 of the WTO DSU). Specifically, whether the Panel set out findings of fact, the applicability of relevant provisions, and the basic rationale behind its findings. The Appellate Body held the Panel did so. *See id.* ¶¶ 249(c)(i), 489-495, 763(c)(i).

(5) Export Credit Guarantees and the Burden of Proof:

Under Appellate Body case law beginning with Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R (Apr. 25, 1997), the burden of proof on a claim lies with the claimant. However, Article 10:3 of the WTO Agreement on Agriculture contains an exception for a claim that a quantity of a product, which exceeded the applicable reduction commitment level, was not subsidized. The burden of proving no subsidy was granted on that quantity lies with the Member claiming the exported, excessive product did not receive a subsidy. The United States alleged the Panel unfairly allocated the burden of proof to it, not Brazil, in finding Export Credit Guarantees are prohibited export subsidies under Article 3:1(a) of the SCM Agreement. Examining the record from the Panel stage, the Appellate Body found no evidence to support this allegation. *See id.* ¶¶ 249(e)(ii), 642-657, 763(e)(ii).

of GATT 1994 and Part III of the *Subsidies Agreement*; and

(iii) exempt from actions based on non-violation nullification or impairment of the benefits of tariff concessions accruing to another Member under Article II of GATT 1994, in the sense of paragraph 1(b) of Article XXIII of GATT 1994;

[A footnote to item (i) explains: "Countervailing duties" where referred to in this Article are those covered by Article VI of GATT 1994 and Part V of the *Agreement on Subsidies and Countervailing Measures*.]

(b) 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, shall be:

(i) exempt from the imposition of countervailing duties unless a determination of injury or threat thereof is made in accordance with Article VI of GATT 1994 and Part V of the *Subsidies Agreement*, and due restraint shall be shown in initiating any countervailing duty investigations;

(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*; and

(iii) exempt from actions based on non-violation nullification or impairment of the benefits of tariff concessions accruing to another Member under Article II of GATT 1994, in the sense of paragraph 1(b) of Article XXIII of GATT 1994, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year;

(c) export subsidies that conform fully to the provisions of Part V of this *Agreement*, as reflected in each

> Member's Schedule, shall be:
>
> > (i) subject to countervailing duties only upon a determination of injury or threat thereof based on volume, effect on prices, or consequent impact in accordance with Article VI of GATT 1994 and Part V of the *Subsidies Agreement*, and due restraint shall be shown in initiating any countervailing duty investigations; and
> > (ii) exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the *Subsidies Agreement*.[434]

In brief, Paragraph (a) is an immunity for Green Box support, i.e., non-trade distorting, or minimally trade-distorting, subsidies. In turn, Annex 2, Paragraph 6(b) of the Agriculture Agreement sets out the parameters of the Green Box. (Annex 2 sets out the exemptions from reductions commitments to the bound level of a WTO Member's Aggregate Measure of Support, or AMS.[435]) This provision must be read in the context of the entirety of Paragraph 6, as well as the preceding Paragraph, 5:

> 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. Where exemption from reduction is claimed for any existing or new type of direct payment other than those specified in paragraphs 6 through 13, it shall conform to criteria (b) through (e) in paragraph 6, in addition to the general criteria set out in paragraph 1.
>
> 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

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434. SCM Agreement, Agreement on agriculture, *both* Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Agriculture, annex 1A, Apr. 15, 1994, 33 I.L.M. 1125 (1994) (emphasis added).

435. For a discussion of domestic support reduction commitments, see generally Raj Bhala, *World Agricultural Trade in Purgatory*, 79 N.D. L. REV. 691 (2003).

> a defined and fixed base period.
> (b) The amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period.
> (c) The amount of such payments in any given year shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period.
> (d) The amount of such payments in any given year shall not be related to, or based on, the factors of production employed in any year after the base period.
> (e) No production shall be required in order to receive such payments.

Paragraph (b) is an immunity for subsidies that would be actionable under Articles 5-6 of the SCM Agreement, known as Yellow Light and Dark Amber subsidies, as long as the amount of those subsidies does not exceed the bound level agreed to by the subsidizing country during the Uruguay Round. Here, then, is the interface between the Peace Clause and SCM Agreement.

Articles 5-6 of the SCM Agreement, which are contained in Part III of the SCM Agreement entitled "Actionable Subsidies," state:

> *Article 5–Adverse Effects*
>
> No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1 [which define a "subsidy" as a financial contribution conferring a benefit that is *de jure* or *de facto* specific to an enterprise or group of enterprises], adverse effects to the interests of other Members, i.e.,:
>
> > (a) injury to the domestic industry of another Member;
> > (b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994 in particular the benefits of concessions bound under Article II of GATT 1994;
> > (c) serious prejudice to the interests of another Member. [A footnote to Article 5(c) explains "[t]he term 'serious prejudice to the interests of another Member' is used in this *Agreement* in the same sense as it is used in paragraph I of Article XVI of GATT 1994, and includes threat of serious prejudice."]
> > This Article does not apply to subsidies maintained on

agricultural products as provided in Article 13 of the *Agreement on Agriculture*.

*Article 6–Serious Prejudice*

6.1. Serious prejudice in the sense of paragraph (c) of Article 5 shall be deemed to exist in the case of:

(a) the total *ad valorem* subsidization of a product exceeding [five] per cent;
(b) subsidies to cover operating losses sustained by an industry;
(c) subsidies to cover operating losses sustained by an enterprise, other than one-time measures which are non-recurrent and cannot be repeated for that enterprise and which are given merely to provide time for the development of long-term solutions and to avoid acute social problems;
(d) direct forgiveness of debt, i.e., forgiveness of government-held debt, and grants to cover debt repayment.
[Subsidies fitting within Article 6.1(a), (b), (c), or (d) are considered "Dark Amber," though Article 6.1(a) has lapsed. "Yellow Light" is the default category for other subsidies under Articles 5-6.]

6.2. Notwithstanding the provisions of paragraph 1, serious prejudice shall not be found if the subsidizing Member demonstrates that the subsidy in question has not resulted in any of the effects enumerated in paragraph 3.

6.3. Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply:

(a) the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member;
(b) the effect of the subsidy is to displace or impede the exports of a like product of another Member from a third country market;
(c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market;

> (d) the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity ["unless," as a footnote here explains "other multilaterally agreed specific rules apply to the trade in the product or commodity in question"] as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted.

6.4. For the purpose of paragraph 3(b), the displacement or impeding of exports shall include any case in which, subject to the provisions of paragraph 7, it has been demonstrated that there has been a change in relative shares of the market to the disadvantage of the non-subsidized like product (over an appropriately representative period sufficient to demonstrate clear trends in the development of the market for the product concerned, which, in normal circumstances, shall be at least one year). Change in relative shares of the market shall include any of the following situations: (a) there is an increase in the market share of the subsidized product; (b) the market share of the subsidized product remains constant in circumstances in which, in the absence of the subsidy, it would have declined; (c) the market share of the subsidized product declines, but at a slower rate than would have been the case in the absence of the subsidy.

6.5. For the purpose of paragraph 3(c), price undercutting shall include any case in which such price undercutting has been demonstrated through a comparison of prices of the subsidized product with prices of a non-subsidized like product supplied to the same market. The comparison shall be made at the same level of trade and at comparable times, due account being taken of any other factor affecting price comparability. However, if such a direct comparison is not possible, the existence of price undercutting may be demonstrated on the basis of export unit values.

6.6. Each Member in the market of which serious prejudice is alleged to have arisen shall, subject to the provisions of paragraph 3 of Annex V, make available to the parties to a dispute arising under Article 7, and to the panel established pursuant to paragraph 4 of Article 7, all relevant information that can be obtained as to the changes in market shares of the parties to the dispute as well as concerning prices of the products

involved.
6.7. Displacement or impediment resulting in serious prejudice shall not arise under paragraph 3 where any of the following circumstances exist during the relevant period:

(a) prohibition or restriction on exports of the like product from the complaining Member or on imports from the complaining Member into the third country market concerned;
(b) decision by an importing government operating a monopoly of trade or state trading in the product concerned to shift, for non-commercial reasons, imports from the complaining Member to another country or countries;
(c) natural disasters, strikes, transport disruptions or other *force majeure* substantially affecting production, qualities, quantities or prices of the product available for export from the complaining Member;
(d) existence of arrangements limiting exports from the complaining Member;
(e) voluntary decrease in the availability for export of the product concerned from the complaining Member (including, *inter alia*, a situation where firms in the complaining Member have been autonomously reallocating exports of this product to new markets);
(f) failure to conform to standards and other regulatory requirements in the importing country.
[A footnote after the word "exist" in the *chapeau* of Article 6.7 explains: "The fact that certain circumstances are referred to in this paragraph does not, in itself, confer upon them any legal status in terms of either GATT 1994 or this *Agreement*. These circumstances must not be isolated, sporadic or otherwise insignificant."]

6.8. In the absence of circumstances referred to in paragraph 7, the existence of serious prejudice should be determined on the basis of the information submitted to or obtained by the panel, including information submitted in accordance with the provisions of Annex V.

6.9. This Article does not apply to subsidies maintained on agricultural products as provided in Article 13 of the *Agreement on Agriculture* [i.e., the *Peace Clause*].

Finally, Paragraph (c) of the Agriculture Agreement Peace Clause immunizes export subsidies that are not otherwise inconsistent with that Agreement.

In launching its challenge to American domestic support programs for cotton, Brazil had no option but to claim first that these programs were not entitled to Peace Clause immunity. Only if the programs were ineligible for this immunity was the second step of the Brazilian attack on them possible—namely, claims under the SCM Agreement (as well as GATT Article XVI:1). The Peace Clause applied during a nine-year transition period, from 1 January 1995 when the Uruguay Round agreements took effect, until 31 December 2003. Brazil brought its case during this period, and the Panel was established on 18 March 2003. Brazil surely and rightly anticipated the threshold American defense—the Peace Clause—and, therefore, had to defeat it at the start.

Brazil did defeat this defense. At the Panel stage, Brazil successfully claimed Production Flexibility Contract Payments and Direct Payments do not qualify under Article 13(a) of the Agreement on Agriculture for immunity from suit under the SCM Agreement. These two programs do not qualify for the Green Box because they link payments to the type of crop grown, which violates the requirement of Annex 2, Paragraph 6(b) of the Agriculture Agreement that payments not be related to the type of production after the applicable base period. To get a subsidy, a farmer must not grow fruit or vegetables.

At the Panel stage, Brazil also succeeded in showing eight domestic support measures failed to qualify under Article 13(b) of the Agriculture Agreement. The amount of support associated with these measures exceeded the Uruguay Round bound level, thus violating the Article 13(b) condition for immunity. These programs, in addition to Production Flexibility Contract Payments and Direct Payments, are:

> (1) Cottonseed Payments (for the 1999, 2000, and 2002 cottonseed crops),
> (2) Counter-cyclical Payments,
> (3) Crop Insurance Payments,
> (4) Market Loss Assistance Payments,
> (5) Marketing Loan Programs, and
> (6) User Marketing (i.e., Step 2) Payments to domestic users (but not to exporters).

In other words, all of the U.S. domestic support measures were non-Green Box support. Because neither sub-paragraph (a) nor (b) of the Peace Clause could shield any of them, all of the measures were vulnerable to Brazil's claims under Articles 5-6 of the SCM Agreement, as well as GATT Article XVI:1.

Why did Brazil not also claim these six programs lacked immunity under Article 13(a)? The answer is there was no need. The United States could not plausibly have said they are within the Green Box. In none of these six programs are payments decoupled from the type or amount of production. But, complete decoupling is the hallmark of non trade-distorting or minimally trade-distorting subsidies, and therefore is the defining feature of the Green Box. Indeed, the United States agreed that Cottonseed Payments, Crop Insurance Payments, Market Loss Assistance Payments, Marketing Loan Program Payments, and Step 2 Payments to domestic users are non-Green Box measures. It also did not assert Counter-Cyclical Payments were Green Box measures, because they are granted in response to low prevailing market prices.[436] Therefore, the disagreement between Brazil and the United States was whether Direct Payments and Production Flexibility Contract Payments conform fully to the provisions of Annex 2 and, hence, satisfied the conditions in paragraph (a) of Article 13.[437]

Of course, Brazil knew well proof that a subsidy measure fits within the Yellow (or Dark Amber) Box renders it actionable, but, in contrast to a Red Light subsidy, not prohibited. The measure is unlawful only if it causes an adverse effect on the complainant. Hence, Brazil had to show the U.S. support programs caused one of the three forms identified as an adverse effect by Article 6 of the SCM Agreement: material injury or threat thereof, nullification or impairment of benefits, or serious prejudice. Brazil opted for proof of serious prejudice in the form of price suppression and an increased world market share.

Brazil persuaded the Panel that several U.S. domestic support measures caused serious prejudice through price suppression. But, it could not prove their seriously prejudicial effect was to boost the U.S. share of the world market. In particular, Brazil successfully urged four measures that led to significant price suppression in the same world market under Article 6:3(c) of the SCM Agreement, and thus seriously prejudiced its interests under Article 5(c) of that Agreement. These four programs, collectively called the "Price-Contingent Subsidies," were:

(1) Counter-Cyclical Payments,
(2) Marketing Loan Program Payments,
(3) Market Loss Assistance Payments, and
(4) Step 2 Payments.

The Panel agreed.[438] Brazil also argued that these mandatory price-contingent measures—plus Cottonseed Payments (for the year 2000 crop), Crop Insurance Payments, Direct Payments, Production Flexibility Contract Payments, and Step 2 Payments (to users and exporters)—increased the share in the world market of the United States within the meaning of Article 6:3(d) of the SCM Agreement. That

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436. *See Cotton* Panel Report, *supra* note 404, ¶ 7.424.
437. *See id.* ¶ 7.425.
438. The Panel rejected Brazil's argument that serious prejudice, in the form of price suppression, was the effect of Crop Insurance Payments, Direct Payments, and Production Flexibility Contract Payments.

increase constituted serious prejudice under Article 5(c). The Panel held that Brazil failed to make this part of its case.

c. U.S. Step 2 Payments, Export Credit Guarantees, and Red Light Subsidies

Brazil identified two U.S. support measures as unlawful export subsidies: Step 2 Payments) made to U.S. exporters of American cotton and export credit guarantees under the GSM 102 and GSM 103 Programs and under the SCGP. Brazil argued the Step 2 Payments and the export credit guarantees ran afoul of two WTO prohibitions. First, they violated Article 10:1 of the Agreement on Agriculture, and could not be justified under Article 10:2 of that Agreement. Second, they were Red Light export subsidies under Article 3:1(a) of the SCM Agreement. On both counts, the Panel agreed.

Step 2 Payments also were available to U.S. users of American cotton. Brazil claimed this availability itself unlawfully favored the use of domestic over imported products. Specifically, channeling funds to users (as distinct from exporters) violated the other prong of Red Light category in the SCM Agreement, i.e., Article 3:1(b) of that Agreement. They were, urged Brazil, import substitution subsidies favoring the use of domestic over imported inputs. Once again, the Panel agreed.[439]

Did Brazil have to pursue the same two-step argumentation structure in attacking the Step 2 Payments (both to exporters and users) and Export Credit Guarantees as it had concerning the eight domestic support programs? That is, did it have to begin by proving the disputed measures were ineligible for immunity under the Peace Clause and then proceed to showing a violation of a WTO text? "Yes, no, and sort of " is the answer.

For Step 2 Payments made to users, there could be no question of Peace Clause immunity. This measure was an import substitution subsidy for an agricultural product, and nothing in the Clause immunized this kind of subsidy. Accordingly, Brazil could, and did, proceed directly to an attack under Article 3:1(b) of the SCM Agreement, which is a flat-out bar on import substitution subsidies. At the Panel stage, the attack succeeded.

For Step 2 Payments to Exporters, and Export Credit Guarantees, it was readily evident that Article 13(a) is irrelevant, because neither Step 2 Payments nor Export Credit Guarantees could be called Green Box support. Their funding

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439. Brazil raised an interesting claim under GATT Article III, contending Step 2 Payments to domestic users violated the Article III:4 national treatment rule. Brazil urged Article III:8(b) did not justify these Payments, because they are not made exclusively to domestic producers of cotton. Rather, they go to users of cotton. As the Panel found Step 2 Payments to users to be Red Light import substitution subsidies, it exercised judicial economy and did not rule on the Article III claim. *Cotton* Appellate Body Report, *supra* note 404, ¶ 518 n.738.

is tied directly to exportation or use of American cotton. Article 13(b) is inapplicable, because whether the United States exceeded bound levels of commitment on export subsidies was not at issue. The United States did not schedule export credit-type programs for reduction commitments. Thus, the third and final prong of the Peace Clause, Article 13(c), is the one Brazil rightly anticipated the United States would invoke.

Article 13(c) gives immunity from suit under the SCM Agreement to farm subsidies consistent with the obligations set out in the Agreement on Agriculture. Thus, Brazil had to reverse the two steps. If it could show, first, that the disputed measures violated some provision of the Agriculture Agreement, then the programs would be vulnerable to attack under the SCM Agreement. Then, in turn, Brazil could make a claim against the program grounded on the SCM Agreement, namely, Article 3:1. What provision of the Agriculture Agreement did the Step 2 Payments and Export Credit Guarantees violate, which took them out from the protective orbit of Article 13(c)?

The answer depends on the specific measure. For Step 2 Payments to exporters of cotton, Brazil said it was Article 9:1(a) of the Agriculture Agreement, which lists unlawful export subsidies. As such, these Payments were not entitled to Article 13(c) immunity, and could be held *per se* illegal as Red Light export subsidies under Article 13(a) of the SCM Agreement. The Panel so held.

For Export Credit Guarantees, Brazil said the relevant provision was Article 10:1 of the Agriculture Agreement. Article 10:1 provides disciplines (albeit limited ones), on export subsidies, and Brazil further argued Article 10:2 does not lift application of the disciplines to these subsidies. Therefore, Export Credit Guarantees were ineligible for the Article 13(c) immunity. In turn, they could be held *per se* illegal as Red Light subsidies under Article 3:1(a) of the SCM Agreement, because they fell squarely within the list of such subsidies in Annex I to that Agreement (in particular, they were covered by Item (j), which identifies export credit guarantees as government offers at a premium rate inadequate to cover the long-term operating costs and losses of the guarantee program). Again, the Panel so held.[440]

#### i. Domestic Support: Major Issues and Synopsis of Appellate Body Holdings[441]

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440. Technically, the Panel distinguished Export Credit Guarantees for unscheduled agricultural products not supported under the GSM 102, GSM 103, or SCGP Programs, as well as other scheduled agricultural products. For such products, the Panel ruled in favor of the United States, saying no violation of Article 10:1 occurred, hence it was entitled to immunity under Article 13:1(c).

441. Additionally, the Appellate Body discussed the following substantive issues, but either declined to rule, or made no significant ruling, on them:

Two broad categories—domestic support and export subsidies—capture the major substantive issues before the Appellate Body. As suggested earlier, on

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(1) Domestic Support, Article 13(a) of the Agreement on Agriculture, and the Base Period Update:

Whether the updating of base acres for Direct Payments under the FSRI Act of 2002 means Direct Payments are not Green Box measures that conform to the Agreement on Agriculture (specifically, Annex 2, Paragraph 6(a)), and thus do not enjoy immunity under the Peace Clause (specifically, Article 13(a)(ii), which requires support be determined by unambiguous criteria for a defined, fixed base period) and can be challenged under Part III of the SCM Agreement and GATT Article XVI. The Appellate Body rejected Brazil's request for a conditional ruling on this issue. *See Cotton* Appellate Body Report, *supra* note 404, ¶¶ 249(b)(i), 343-344, 763(b)(i).

(2) Domestic Support, Article 13(b) of the Agreement on Agriculture, and the Price Gap Methodology:

Whether the only way to gauge the value of Marketing Loan Program Payments and Deficiency Payments for purposes of the Article 13(b)(ii) immunity (i.e., to ascertain whether the level of support provided by a measure in the implementation period exceeds the bound level set at MY 1992) is the Price Gap Methodology described in Annex 3, Paragraph 10, of the Agreement on Agriculture. The U.S. said the answer is "yes," but the Appellate Body declined to rule on the issue. *See id.* ¶¶ 249(b)(ii), 385-390, 763(b)(ii).

(3) Serious Prejudice, the Meaning of "World Market Share," and the Effect of Price-Contingent Subsidies:

In articulating criteria for whether a Yellow Light subsidy causes "serious prejudice," Article 6:3(d) of the SCM Agreement uses the phrase "world market share." Brazil said the phrase means the share held by a WTO Member in the world market for exports. It presented evidence the U.S. share of the world market for exports had increased. The United States said the phrase referred to all consumption of a product, here cotton, including consumption by the WTO Member of its own production (here, U.S. consumption of American cotton). The Panel rejected both the Brazilian and American definitions of "world market share." The Panel interpreted this term to mean the "share of the world market supplied by the subsidizing Member of the product concerned." The Appellate Body neither upheld nor reversed the definition given by the Panel, saying it was unnecessary to do so. Brazil argued U.S. Counter-Cyclical Payments, Market Loss Assistance Payments, Marketing Loan Program Payments, and Step 2 Payments, i.e., the four Price-Contingent Subsidies, increased the American share of the world market for cotton. The Appellate Body declined to rule on this argument. In sum, the Appellate Body did not make any ruling under Article 6:3(d) of the SCM Agreement. *See id.* ¶¶ 249(c)(ii), 497-512, 763(c)(ii).

domestic support, Brazil argued U.S. measures did not qualify for Peace Clause immunity, and thus could be challenged as actionable (Yellow Light) subsidies. Brazil challenged them as such, claiming they caused serious prejudice, specifically, price depression. The Panel agreed with Brazil. The United States appealed, placing before the Appellate Body the following issues, some of which are best understood by disaggregating them into discrete questions.

a) Article 13(a) of the Peace Clause and the Green Box[442]

Are two of the eight disputed U.S. domestic support measures—Production Flexibility Contract Payments and Direct Payments—Green Box measures, as Annex 2, Paragraph 6(b) of the Agreement on Agriculture defines that Box, and thus entitled to immunity under Article 13(a)(ii) of the Peace Clause? Upholding the Panel's finding, the Appellate Body answered no, thus opening these two measures to attack under the SCM Agreement.

b) Article 13(b) of the Peace Clause, and Non-Green Box Support[443]

Do U.S. domestic support measures that do not qualify for the Green Box, and thus are not entitled to immunity under Article 13(a)(ii) of the Peace Clause in the Agreement on Agriculture, also fail to qualify for immunity under Article 13(b)(ii) of the Clause? In particular, do the measures provide support to cotton in excess of the level for MY 1992, which is the bound level to which the United States committed during the Uruguay Round? Upholding the Panel's finding, the Appellate Body answered yes, thus rendering eight measures vulnerable to challenge under the SCM Agreement. The eight measures, which the Appellate Body dubbed collectively as the "Challenged Domestic Support Measures," are:

(1) Cottonseed Payments (for 1999-2001),
(2) Counter-Cyclical Payments,
(3) Crop Insurance Payments,
(4) Direct Payments,
(5) Market Loss Assistance Payments,
(6) Marketing Loan Program Payments,
(7) Production Flexibility Contract Payments, and
(8) User Marketing (Step 2) Payments to domestic users (not exporters).

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442. *See id.* ¶¶ 249(b)(i), 763(b)(i).
443. *See id.* ¶¶ 249(b)(ii), 763(b)(ii).

To decide this issue, the Appellate Body had to resolve three specific questions:

> ● First, does the phrase "grant support to a specific commodity" in Article 13(b)(ii) of the Peace Clause refer broadly to all non-Green Box measures that explicitly or clearly define a commodity as the one to which they bestow support, or does this phrase refer narrowly to "product-specific domestic support?" The Panel interpreted the phrase to have the first meaning. Modifying this interpretation, the Appellate Body said "support to a specific commodity" refers not only to "product-specific support," but also to non-product-specific support granted to an identified commodity.
> ● Second, assuming the aforementioned phrase is interpreted broadly, do the Challenged Domestic Support Measures explicitly or clearly define cotton as the one to which they bestow support? Upholding the Panel's finding, the Appellate Body responded yes, i.e., that each Measure grants support to a specific commodity, namely, cotton.
> ● Third, does the amount of the Challenged Support Measures to cotton for 1999-2002 exceed the ceiling to which the United States committed in the Uruguay Round, namely, the level in MY 1992, thus rendering the Measures ineligible for Article 13(b)(ii) Peace Clause immunity? Upholding the Panel's finding, the Appellate Body responded yes.

c) Domestic Support, Yellow Light Subsidies, and Serious Prejudice[444]

If the Challenged Domestic Support Measures are not entitled to Article 13(b)(ii) Peace Clause immunity, and are thus subject to challenge under the SCM Agreement, are they actionable (Yellow Light) subsidies under Articles 5-6 of that Agreement? Upholding the Panel's conclusion, the Appellate Body said yes.

Following logically, if the Challenged Domestic Support Measures are Yellow Light subsidies, then do they cause an adverse trade effect, specifically, serious prejudice, and thus constitute unlawful subsidies under the SCM Agreement? Specifically, do four of these Measures—the Price-Contingent Subsidies, which are (1) Counter-Cyclical Payments, (2) Market Loss Assistance Payments, (3) Marketing Loan Program Payments, and (4) Step 2 Payments—

444. *See id.* ¶¶ 249(b)(ii), (c)(i), 763(b)(ii), (c).

cause significant price suppression according to Article 6:3(c) of the SCM Agreement? The Appellate Body replied yes.

In coming to this response, the Appellate Body had to deal with the following detailed questions:

> ● Article 6:3(c) states "the effect of the subsidy is . . . significant price suppression . . . in the same market." May the "same market" be a "world market"? If so, then is there a "world market" for cotton? Further, does the so-called "A-Index" reflect a world price in the world market for cotton? The Appellate Body agreed with the Panel's findings, namely, that the "same market" may be a "world market," that a "world market" for cotton exists, and that the A-Index reflects a world price in this market.[445]
>
> ● Is "significant price suppression" under Article 6:3(c) the effect of the Price-Contingent Subsidies? That is, does a causal link exist between these subsidies and price suppression, which other factors do not attenuate? Moreover, is it necessary to quantify the benefit Price-Contingent Subsidies confer on cotton? Like the Panel, the Appellate Body found a causal link between Price-Contingent Subsidies and price suppression for MY 1992-2002, other factors raised by the United States did not attenuate this link, and there is no legal requirement to quantify precisely the benefit conferred by these Subsidies on cotton.[446]

ii. Export Subsidies: Major Issues and Synopsis of Appellate Body Holdings[447]

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445. *See Cotton* Appellate Body Report, *supra* note 404, ¶ 763(c)(i)(A).

446. *See id.* ¶ 763(c)(i)(B).

447. Additionally, the Appellate Body discussed the following substantive issues, but either declined to rule, or made no significant ruling, on them:

> (1) Export Credit Guarantees and Circumvention:
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> Article 10:1 of the Agreement on Agriculture disciplines export subsidies applied in a manner resulting in, or threatening, circumvention of export subsidy commitments. Brazil claimed Export Credit Guarantees for pig and poultry meat in 2001 circumvented American commitments on export subsidies, and thus violated Article 10:1 of the Agreement. The Panel held Brazil failed to make its case. The Appellate Body overruled the Panel, but said there were insufficient uncontested facts to determine whether the United States had committed a violation. The Appellate Body also modified the Panel's interpretation of the phrase in Article 10:1, namely, "threatens

As for export subsidies, Brazil's attack focused on two U.S. programs—Step 2 Payments and Export Credit Guarantees. On appeal, there were three issues of major substantive importance. Technically, the first issue—involving Step 2 Payments to users, as distinct from exporters—is one of import substitution, not export subsidization. However, as Article 3 of the SCM Agreement deems both *per se* illegal, properly they are considered together.

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to lead to . . . circumvention," saying the Panel erred in suggesting a condition for finding threat of circumvention is an "unconditional legal entitlement" to receive an export subsidy. The Appellate Body upheld the Panel's finding Brazil failed to establish Export Credit Guarantees for scheduled agricultural products other than rice, and other unscheduled agricultural products not supported under the disputed measures, threatened circumvention in violation of Article 10:1. *See id.* ¶¶ 249(f), 675-719, 763(f).

(2) Export Credit Guarantees and Articles 1:1 and 3:1(a) of the SCM Agreement:

Brazil alleged U.S. export subsidies under the Step 2 Program (described above) were Red Light subsidies under Article 3:1(a) of the SCM Agreement. It prevailed in this argument on the factual predicate that Step 2 payments fit within the list of export subsidies to that Agreement, specifically, Item (j) of Illustrative List of Export Subsidies annexed to the Agreement. Brazil worried if the Appellate Body reversed the Panel's conclusion that Step 2 payments properly were categorized in Item (j), then Brazil might not have put before the Appellate Body an alternative factual predicate to show the payments indeed were prohibited export subsidies. Thus, Brazil offered a second ground for this finding. Essentially exercising judicial economy, the Appellate Body upheld the Item (j) classification, and declined to rule on whether the alternative basis sufficed. *See id.* ¶¶ 249(e)(v), 720-733, 763(e)(v).

(3) FSC Repeal and Extraterritorial Income Exclusion Act of 2000:

Brazil called on the Appellate Body to overrule a finding of the Panel concerning legislation the U.S. Congress enacted (the FSC Repeal and Extraterritorial Income Exclusion Act of 2000, known informally as the ETI Act, which is Public Law 106-519) to resolve the *U.S. – EU Foreign Sales Corporation* dispute. The Panel held Brazil failed to establish a *prima facie* case this Act and the subsidies granted under it violated Articles 8 and 10:1 of the Agreement on Agriculture and Article 3:1 of the SCM Agreement. The Appellate Body declined to reverse the Panel. The Appellate Body also discussed a Brazilian claim under GATT Article XVI:3, but did not rule on it. This matter is discussed in the Commentary below. *See id.* ¶¶ 249(g), 734-748, 763(g).

a) Step 2 Payments to Users as Red Light Import Substitution Subsidies[448]

Are Step 2 Payments to domestic users of American cotton subsidies contingent on the use of domestic over imported goods and, therefore, import substitution subsidies that are *per se* illegal under the Red Light category of Article 3:1(b) of the SCM Agreement? Upholding the Panel's finding, the Appellate Body replied yes.

b) Step 2 Payments to Exporters as Red Light Export Subsidies[449]

Are Step 2 Payments to exporters of American cotton subsidies contingent on export performance under Article 9:1(a) of the Agreement on Agriculture and, therefore, not only inconsistent with Articles 3:3 of that Agreement, but also *per se* illegal export subsidies under the Red Light category of Article 3:1(a) of the SCM Agreement? Again upholding the Panel's finding, the Appellate Body said yes.

c) Export Credit Guarantees as Red Light Export Subsidies[450]

Are Export Credit Guarantees—specifically, the GSM 102, GSM 103, and SCGP measures—illegal Red Light export subsidies under Article 3:1(a) of the SCM Agreement? Like the Panel, the Appellate Body said yes. To reach this conclusion, the Appellate Body had to address two specific questions:

- Does Article 10:2 of the Agreement on Agriculture exempt export credit guarantees from the export subsidy disciplines of Article 10:1? The Panel replied no. Two of the three Appellate Body members agreed with the Panel. Significantly, one member dissented, saying Article 10:2 does carve out export credit guarantees from the Article 10:1 disciplines.[451]

448. *See id.* ¶¶ 249(d)(i), 763(d)(i).

449. *See Cotton* Appellate Body Report, *supra* note 404, ¶¶ 249(d)(ii), 763(d)(ii).

450. *See id.* ¶¶ 249(e)(i), (iii)-(iv), 763(e)(i), (iii)-(iv).

451. The Presiding Member was Merit E. Janow. The other Members were Luiz Olavo Baptista and A.V. Ganesan. *See id.* at 295. For what little it may be worth, the authors speculate—with no supporting evidence other than the familiar American style of writing judicial opinions, which of course may be imitated, and a gut instinct about the rationale of the dissent—the dissenter was the Presiding Member.

● If Article 10:2 does not provide this exemption, then are Export Credit Guarantees within Item J on the Illustrative List of Export Subsidies annexed to the SCM Agreement? That is, does the United States provide these Guarantees at premium rates inadequate to cover long-term operating costs and losses, as Item J states? The Panel and Appellate Body answered yes.

iii. Domestic Support Issues: Analysis of Appellate Body Holdings and Rationales

Following the bifurcation of issues in the *Cotton* case into domestic support and export subsidies, and treating the Step 2 payments to users in the latter category though it technically involves import substitution, the holdings and rationale of the Appellate Body are analyzed below. Perhaps the most striking feature of the entire case is how thin the Appellate Body holdings and rationale are. In a monstrously long opinion, the Appellate Body adds little value to the findings and reasoning of the Panel. On most domestic support and export subsidy issues, the Appellate Body reiterates and blesses the work of the Panel.

a) Article 13(a) of the Peace Clause and the Green Box[452]

The United States conceded that the amount of Production Flexibility Contract Payments and Direct Payments depended on a formula in which base acreage of historical cotton production was the central variable. The United States also conceded the existence of production flexibility limits on the ability of a farmer to plant any crop and still receive the same amount, or any, Payment. However, the United States insisted a farmer could receive a Payment regardless of what the farmer grew, and whether it produced any product at all.

In particular, the United States argued the Panel was wrong to characterize the production flexibility limitations (the rule that Payments would be cut or eliminated if the farmer grew fruit or vegetables) as relating payments to the type of production after the base period. That mistake caused the Panel to take these Payments out of the Green Box as defined by Annex 2, Paragraph 6(b) of the Agreement on Agriculture, and thus to deny the Payments Peace Clause immunity under Article 13(a) of the Agreement. The essence of the error was that the Panel believed a negative direction—a rule conditioning payment on the non-production of certain crops—made the amount of payments "related to the type of production" within Paragraph 6(b). In truth, the United States reasoned that only a positive direction not to produce would "relate" payments to production.

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452. *See Cotton* Appellate Body Report, *supra* note 404, ¶¶ 249(b)(i), 310-344, 763(b)(i).

To read and reiterate the United States argument is to detect the logical flaw, namely, there is no material difference in the effect of a positive or negative direction. A positive direction, which highlights permitted crops (i.e., lists the crops to be grown to get a subsidy) would be as follows: "Uncle Sam says if you, the farmer, grow cotton, then you will get a payment." A negative direction, which segregates prohibited crops, would be as follows: "Uncle Sam says if you, the farmer, grow fruit or vegetables, then you will not get a payment (or your payment will be cut)." As Brazil pointed out, the practical repercussion of either kind of direction is the same. A farmer is channeled away from certain crops, for which no or a reduced payment is made, and toward other crops, for which a payment is made. Under the Production Flexibility Contract and Direct Payments schemes, full support is given if permitted crops are grown on base acreage, and the larger the output of prohibited crops planted, the greater the reduction in support.

To be sure, the American argument was not illogical. For example, in negotiating foreign direct investment (FDI) entry, both in the context of WTO accessions and Mode III service schedule requests and offers under the General Agreement on Trade in Services (GATS), there are two possible approaches: a Negative List and a Positive List.[453] The premise of a Negative List is FDI in all sectors is permitted except for the sectors specifically itemized on the List, which are off limits to foreigners. The premise of a Positive List is the mirror image, i.e., FDI in all sectors is forbidden to foreigners, except for the sectors itemized on the List. Which approach is the more trade liberalizing of the two? Obviously, the answer is the Negative List approach. In many WTO accession negotiations, and GATS talks, the United States has urged countries to switch from a Positive to Negative List approach and to trim the Negative List to a minimum. The point is that either kind of List can, in practice, yield the same degree of market access, but one List starts from an anti-free trade perspective, while the other begins with a pro-free trade perspective.

To rebut Brazil's appellate argument, the United States could have drawn an analogy between Negative and Positive Lists, on the one hand, and negative and positive agricultural support directives, on the other hand. A negative directive, like the production flexibility limitations, starts from the premise of freedom-of-choice as to what crops to plant, while a positive agricultural support direction starts with the premise of telling a farmer what to plant. True, in the extreme, if a negative directive rules out production of all crops except for one, then it is no different from a positive direction. Ruling out fruit and vegetables, as the Production Flexibility Contract and Direct Payment programs did, may approach this extreme. But, there are a lot of non-fruit, non-vegetable crops left

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453. *See, e.g.*, Raj Bhala, *Saudi Arabia, the WTO, and American Trade Law and Policy*, 38 INT'L LAW. 741 (2004) (discussing, *inter alia*, negotiations between the United States and the Kingdom of Saudi Arabia over FDI restrictions proposed by the Kingdom during WTO accession talks).

from which a farmer may choose. In brief, the United States could have explained that a sufficiently loose negative direction decouples payments from production, and thus are non or minimally trade distorting, as Green Box schemes should be, in the same way a nicely trimmed Negative List liberalizes FDI in an accession negotiation or under the GATS.

Unfortunately, the United States did not offer this analogy. Whether the analogy might have tipped the case in America's favor is uncertain. The Appellate Body proceeded to accept the Brazilian argument and uphold the Panel's finding, on the predictable ground of the *Oxford English Dictionary* (*OED*). Impressively citing both the *Shorter OED* and *The New Shorter OED*, it explained the meaning of "related to" in Annex 2, Paragraph 6(b) of the Agreement on Agriculture as a degree of relationship or connection between two things, such as the amount of payment, on the one hand, and the volume or type of production, on the other hand.[454] A negative direction prohibiting an act, or a positive direction calling for an act, had no bearing on the ordinary meaning of "related to," i.e., two things could be related through either kind of direction. Moreover, the fundamental feature of Green Box support—that it be decoupled from the volume and type of production—could be undermined by a negative or positive contingency on payments.

To its credit, the United States pointed to Paragraph 6(e) of Annex 2 of the Agreement on Agriculture. The United States urged that permission to limit permissible crops via a negative direction may be inferred from the statement in Paragraph 6(e) "[n]o production shall be required in order to receive such payments [i.e., decoupled income support]." This statement prohibits a positive requirement to produce. That is, Paragraph 6(e) forbids a WTO Member from conditioning Green Box support on production, implying a Member is free to require no production whatsoever. Conceivably, a Member could condition support on a total ban on production. That ban would "relate" the payment to volume—namely, zero—under Paragraph 6(b), yet excused by Paragraph 6(e). If Paragraph 6(e) excuses a total ban, then surely it also allows something short of a total ban, namely, a partial exclusion of products, such as for fruits and vegetables.

The Appellate Body, perhaps irritated by inferential reasoning that might undermine its lexicographic certainty, acknowledged the American argument and then essentially said "never mind, a total ban on production of all crops in exchange for payments is not the issue in this case."[455] The Appellate Body summed up the Panel's point that a total production ban would have no positive effect on output, but a partial exclusion vis-à-vis production flexibility limits would have a positive production effect by channeling the efforts of farmers into growing crops eligible for payments. The larger the number of excluded crops, the greater the stimulatory effect on output of permitted crops. That is the kind of

454. *See Cotton* Appellate Body Report, *supra* note 404, ¶ 324 & nn.314-15.
455. *See id.* ¶¶ 327-328.

coupling—a significant constraint on production decisions—that takes a support measure out of the Green Box.

The Appellate Body might have done well to take more seriously than it seemed to have the logical inference drawn by the United States and its implication for the Green Box. No or minimal trade distortion is the hallmark of measures in the Green Box. Perhaps, as the Appellate Body contended, the United States fell short of proving that statistically, production flexibility limitations have no, or at most minimal, trade-distorting effects. But, is the Panel's logic about positive output effects suspect?

A total ban on the production of all crops, in exchange for a subsidy, is a set-aside payment (i.e., money to set aside land from production) in the extreme that would have a negative effect on output of the forbidden product. Because domestic output of that product declines, any exportable surplus also falls. Indeed, there may be no output left to export. A decline or end to exports of the product is a trade distortion. A partial exclusion, associated with Production Flexibility Contract Payments and Direct Payments, stimulates output of cotton, but discourages output of the excluded products, namely, fruit and vegetables. Possibly, the exportable surplus of these products declines, or is wiped out. Is there a difference between the trade-distorting effects of a total ban versus a partial exclusion? The answer may be "empirically yes, but conceptually no." Both a ban and a limit have the potential to distort trade, and whether the effect is "minimal" is a case-to-case empirical matter. If that is the answer, then under Paragraph 6(b) and (e) of Annex 2 to the Agriculture Agreement, should there be a rebuttable presumption that the Green Box contains support measures whether they condition payment on a total ban or partial exclusion, with the presumption rebutted by empirical tests of non-*de minimis* trade distortion?

#### b) Article 13(b) of the Peace Clause, and Non-Green Box Support[456]

Given that none of its eight Challenged Domestic Support Measures fit within the Green Box, the United States took the logical next move: they were immunized by a different sub-paragraph of the Peace Clause, namely, Article 13(b) of the Agreement on Agriculture. The amount of support given through these non-Green Box Measures did not exceed the commitment level to which the United States agreed during the Uruguay Round. As the Proviso Clause of Article 13(b)(ii) states, the threshold is the "grant [of] support to a specific commodity in excess of that decided during the 1992 marketing year . . . ." To be sure, Article 13(b) does not exempt non-Green Box measures from reduction commitments, but rather insulates them from claims that they are actionable Yellow Light subsidies under Articles 5-6 of the SCM Agreement (or claims under GATT Article XVI:1).

456. *See id.* ¶¶ 249(b)(ii), 345-94, 763(b)(ii).

The United States said its level of support to cotton for the years 1999-2002 did not exceed the 1992 benchmark, thus satisfying the Proviso Clause and, in turn, qualifying for the Article 13(b) immunity.

Appealing the Panel's rejection of its argument, the United States made two arguments. First, the Panel erroneously defined the phrase in the Proviso Clause "grant support to a specific commodity" to mean more than "product-specific support." The United States said the Panel should not have included non-product specific support in considering whether the United States exceeded its 1992 benchmark. By arguing for a narrow definition of the phrase, four of the Challenged Domestic Support Measures—(1) Counter-Cyclical Payments, (2) Direct Payments, (3) Market Loss Assistance Payments, and (4) Production Flexibility Contracts—would be excluded from the calculation of support the United States had granted to cotton.[457]

These four measures had in common the fact that they were base-acre dependent payment schemes (and the Appellate Body dubbed them collectively as such). That is, the amount of support to a farmer depended on base acreage upon which certain commodities were grown in a base period. Conceptually, an ascertained quantity of cotton would be calculated by multiplying historical planning, the base acreage, with the historical per acre yield. Then, the support provided to a farmer would be the product of the ascertained quantity of cotton. In formulaic terms:

| | | |
|---|---|---|
| Ascertained Quantity of Cotton | = | (Cotton Base Acres) x (Historical per acre Yield of Cotton) |
| Amount of Support | = | (Ascertained Quantity of Cotton) x (Payment Rate for Cotton) |

457. At the panel stage, the United States accepted that Deficiency Payments, Marketing Loan Program Payments, and Step 2 Payments are relevant for purposes of the comparison called for by Article 13(b)(ii) of the Agreement on Agriculture. The United States also agreed that (1) Cottonseed Payments, (2) Marketing Loan Program Payments, and (3) Step 2 Payments are product-specific support. However, the United States argued Crop Insurance Payments are non-product-specific support. The United States also argued that (1) Counter-Cyclical Payments, (2) Crop Insurance Payments, (3) Direct Payments, (4) Market Loss Assistance Payments, and (5) Product Flexibility Contract Payments do not grant support to a specific commodity. The Panel rejected the United States' arguments. *See Cotton* Panel Report, *supra* note 404, ¶¶ 7.521, .576.

At the appellate stage, the United States did not contest the Panel's conclusion that four Challenged Domestic Support Measures result in "support to a specific commodity." These four Measures were (1) Cottonseed Payments, (2) Crop Insurance Payments, (3) Marketing Loan Program Payments, and (4) Step 2 Payments. The United States also did not appeal this finding with respect to the predecessor of Production Flexibility Contracts, i.e., the Deficiency Payments program.

Of course, under the base-acre dependent payment schemes, cotton was among the eligible commodities, but a farmer may or may not grow it on the base acreage. Stated differently, "base acres" are a hypothetical acreage amount used to calculate decoupled payments to farmers. They do not necessarily correspond to "physical acres," because farmers are free to choose what crop to produce, or to produce no crops.

Obviously, if the United States could persuade the Appellate Body to define the key phrase in the Proviso Clause narrowly, then it would qualify for Peace Clause immunity under Article 13(b). That is because the amounts of the remaining four Challenged Domestic Support Measures, which were properly included as "support to a specific commodity," would not exceed the cap in the Proviso Clause.

To laymen, most lawyers not specializing in international trade, and even to some trade lawyers, "support to a specific commodity" and "product-specific support" would appear to be synonymous phrases. Two of the words are the same in the two constructions. "Commodity" and "product" are interchangeable. The ordinary meaning of "support," "specific," and "commodity"/"product" would not seem to change by the articles "to" and "a." But, the world of WTO adjudication is peculiar, and the American argument was not a winner.

Upholding the Panel, and agreeing with Brazil's rebuttal position, the Appellate Body ruled "support to a specific commodity" covers not only product-specific support, or support directed specifically at only one product, but also all non-Green Box measures, including non-product specific support, which explicitly or clearly define a commodity as one to which support is bestowed. Citing the definition of "specific" in *The New Shorter OED*, the Appellate Body enlightened the world trade community with the following three paragraphs:

> 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" and as "specially or peculiarly pertaining to a particular thing or person, or a class of these; peculiar (*to*)." 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 that clearly or explicitly define a commodity as one to which they bestow or confer support." 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. 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.
>
> . . .
>
> 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."

In sum, as long as a measure specifies a commodity, through a discernible link that may be direct or indirect, and confers support on that commodity, then it is "support to a specific commodity" within the meaning of the

Proviso Clause. What the United States had accomplished was to show that parts of the Agriculture Agreement were sloppily drafted. The Appellate Body had demonstrated, once again, that it admires literalism more than sensibility, and it easily sacrifices rhetorical power for convoluted, somniferous sentences.[458]

The second appellate argument raised by the United States concerned the way in which the Panel gauged the amount of funds granted to cotton under two of the Challenged Domestic Support Measures—Marketing Loan Program Payments and Deficiency Payments. The Panel used the Budgetary Outlay Methodology, which as its name suggests, looks at total expenditures from the government budget. The United States urged that the Panel should have used the Price-Gap Methodology, which is set out in Annex 3, Paragraph 10, of the Agreement on Agriculture. Both Marketing Loan Program and Deficiency Payments are price-based measures, i.e., the size of payments depend on a difference between two prices. The United States argued that only the Price-Gap Methodology gives a true picture of support, because it filters out fluctuations in market prices. The United States corrected the Panel's calculations by using this Methodology, thereby showing its product-specific support never exceeded the 1992 benchmark.

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458. In holding the phrase "support to a specific commodity" includes, but is not limited to, "product-specific support," the Appellate Body made two further points.

First, the Appellate Body rejected the U.S. reasoning that these two phrases are synonymous with two other phrases in the Agriculture Agreement: "support for basic agricultural products" (used in Article 1(h)), and "support . . . provided for an agricultural product in favor of the producers of the basic agricultural product" (used in Article 1(a)). The Appellate Body said if the drafters of the Agreement had meant all four phrases to have the same meaning, then they would have used one and the same phrase. *See Cotton* Appellate Body Report, *supra* note 404, ¶¶ 364-368.

Second, the Appellate Body said the *chapeau* to Article 13(b) is part of a single sentence with the Proviso Clause in Article 13(b)(ii). The *chapeau* speaks of "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 well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6 . . . ." In general, Article 6 deals with Amber Box measures and reduction commitments thereto. Article 6:2 covers domestic support measures provided by developing countries (the "Development Box"), and Article 6:5 deals with Blue Box measures (e.g., production set-aside payments). For all these measures, the distinction between product-specific and non-product-specific support is irrelevant. If this distinction does not matter in the *chapeau*, the Appellate Body suggested, then it must also be immaterial in the Proviso Clause, because this Clause links itself to the *chapeau* with the words "such measures." Put conversely, if "support to a specific commodity" in the Proviso Clause meant, as the United States argued, only product-specific support, then the measures covered by the *chapeau* would be confined to product-specific support, and that would defeat both the plain meaning and the purpose of Article 13(b). *Id.*

The second American argument was the weaker of the two.[459] The Appellate Body accepted Brazil's three-point rebuttal. First, the language of Annex 3, Paragraph 10, of the Agriculture Agreement permits use of either the Budgetary Outlay or Price-Gap Methodology. In other words, there was no textual basis for the narrow U.S. construction that only the latter method could be used to measure the amount of funding channeled through price-based subsidies. Second, the American argument was hypocritical. In its WTO notifications (in the context of meeting domestic support reduction commitments) on the level of support conferred by the Marketing Loan Program, for purposes of calculating the base level AMS, and all subsequent AMS levels, the United States used the Budgetary Outlay Methodology. These notifications created a legitimate expectation on which Brazil should be entitled to rely to determine whether the United States qualified for Peace Clause protection. Brazil's third rebuttal point was the most damning of all. Even if the Price Gap Methodology were applied to Marketing Loan Payment Programs and deficiency payments, total U.S. support still exceeded the 1992 benchmark in each of the relevant years.

c) Yellow Light Subsidies and Serious Prejudice[460]

Not only were the Challenged Domestic Measures non-Green Box Support under the Agreement on Agriculture, but they also were Yellow Light Subsidies under the SCM Agreement. Indeed, the latter categorization is not a distinct issue in the Appellate Body Report. Rather, it is implicit and may be inferred from the attention given in the Report to the issue of serious prejudice. A Yellow Light, or actionable, subsidy under Articles 5-6 of the SCM Agreement is actionable only if it causes an adverse effect, which may be material injury (or threat thereof), nullification or impairment of benefits, or serious prejudice. As indicated earlier, Brazil chose to prove serious prejudice through price suppression, which it did successfully at both the Panel and Appellate Body stages. The United States appealed the Panel ruling that the four Challenged Measures that were Price-Contingent Subsidies—namely, (1) Counter-Cyclical

459. Nevertheless, the United States scored a minor victory regarding the second argument. The Appellate Body agreed it was wrong to include payments to commodities other than cotton, and payments to farmers who produced no commodities at all, as part of the support granted to cotton for purposes of the Article 13(b)(ii) calculation. Only funds flowing to cotton should be included in that calculation, said the Appellate Body, and it rejected the Panel's methodology insofar as it was over-inclusive. *See id.* ¶¶ 375-384. This victory was minor, in that farmers with cotton base acreage overwhelmingly tended to plant cotton, and the Panel included in its Report a calculation offered by Brazil using an alternative method, known as "cotton-to-cotton," which allocated payments associated with one cotton base acre to each planted acre of cotton.

460. *See id.* ¶¶ 249(b)(ii), (c)(i), 395, 400-484, 496-512, 763(b)(ii), (c).

Payments, (2) Market Loss Assistance Payments, (3) Marketing Loan Program Payments, and (4) Step 2 Payments—caused price suppression.

On appeal, the United States and Brazil stipulated that a complaining WTO Member, here, Brazil, must identify the market in which it alleges that the effect of a subsidy is significant price suppression under Article 6:3(c) of the SCM Agreement. Brazil argued there were four such markets for cotton in which the Price-Contingent Subsidies caused price suppression:

> (1) the world market;
> (2) the Brazilian market;
> (3) the U.S. market; and
> (4) [forty] different third-country markets to which both Brazil and the United States exported cotton.

In other words, Brazil said proof of significant price suppression may apply to any market—local, global, and everything in between. The United States said the relevant market must be a particular domestic market of a Member, and cannot be a world market. Thus, the two sides disagreed over the meaning of the word "market" in the Article 6:3(c) phrase "the effect of the subsidy is . . . significant price suppression in the *same market* [emphasis added]."

The nearly 100 paragraphs (from 400 to 496 in the *Cotton* Report) the Appellate Body devotes to the topic of serious prejudice largely amount to a stamp of "Affirmed" on the Panel Report. The Appellate Body begins by agreeing with the Panel that the text of Article 6:3(c) of the SCM Agreement imposes no geographic limitation on a market, or even refers to imports and exports, and that whether a market is geographically bound depends on the nature of the product and the possibility of trading that product across distances. The Panel quoted, and the Appellate Body re-quotes, the ordinary meaning of the word "market" from *The New Shorter OED*—namely, "a place . . . with a demand for a commodity or service"—and even seemed to one-up the Appellate Body by citing the *Merriam-Webster Dictionary Online*.[461] The descriptive adjective "same" in front of the noun "market" does not alter these conclusions. It underscores that the products in issue must be "like," but on the likeness of unsubsidized Brazilian and subsidized American cotton, there was no dispute.

To be fair to the Appellate Body, it supplemented the Panel's discussion of "same market" by laying down a test for when two products can be considered "in the same market" in an Article 6:3(c) price suppression claim. As long as the products are in actual or potential competition, they are "in the same market." Inclusion of potential competition in the test means the products need not be sold at the same time or place.

Like the Panel, the Appellate Body found the U.S. argument—there was no world market for cotton—unpersuasive because the A-Index was an adequate

461. *See id.* ¶ 404.

measure of the world price for cotton. The Appellate Body further agreed that once price suppression is shown in the world market, it may be unnecessary to examine if it occurs in individual country markets. The United States urged that the Panel, having defined the "same market" as the world market, did not do enough by concluding that the world cotton price was suppressed. The Panel should have ascertained whether the price of Brazilian cotton in the world market had been suppressed significantly. Not so, said the Appellate Body—world market price suppression suffices under Article 6:3(c), which does not require separate country analyses.

As for why significant world market price suppression occurred—i.e., showing it was the causal effect of the Price-Contingent Subsidies—the Appellate Body recounted the Panel's holdings and rationale:

> 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) 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." Next, the Panel found that the price suppression it had found to exist was "significant" price suppression under Article 6.3(c), "given the relative magnitude of United States production and exports, the overall price trends we identified in the world market, . . . the nature of the mandatory United States subsidies in question . . . and the readily available evidence of the order of magnitude of the subsidies."
>
> 420. The Panel went on to find that "a causal link exists between" the price-contingent subsidies and the significant price suppression it had found, for four main reasons:
>
> > [T]he United States exerts a substantial proportionate influence in the world upland cotton market.
> >
> > [T]he [price-contingent subsidies] are directly linked to world prices for upland cotton, thereby insulating United States producers from low prices.
> >
> > [T]here is a discern[i]ble temporal coincidence of suppressed world market prices and the price-contingent United States subsidies.

> [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.

421. Finally, the Panel found that the following "other causal factors alleged by the United States" [footnote omitted] "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:'"

> [W]eakness in world demand for cotton due to competing, low-priced synthetic fibres, and weak world economic growth.
>
> [B]urgeoning United States textile imports, reflecting the strong United States dollar since the mid-1990s and declining United States competitiveness in textile and apparel production[.]
>
> [T]he strong United States dollar since the mid-1990s[.]
>
> China subsidized the release of millions of bales of government stocks between 1999 and 2001[.]
>
> [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.

The Appellate Body upheld the Panel's findings and justifications. In so doing, the Appellate Body rejected the U.S. argument that the Panel had committed three errors:

(1) The Panel failed to analyze decisions of U.S. farmers as to whether to plant cotton or other crops. It focused on the expected market price at time of harvest, not the current price at time of planting. The price expected at harvest was higher than

> the income guarantee set by the loan rate in the Marketing Loan Program, suggesting that the effect of the subsidy on planting decisions was minimal. Brazil countered that farmers decide what to plant based on both expected market prices and expected subsidies. For virtually the entire MY 1999-2002 period, the adjusted world price was below the loan rate. The further the price fell, the greater the extent to which American cotton farmers were insulated from the decline, thus numbing their production decisions from world price signals. Indeed, more than half of the revenue of U.S. cotton producers came from Marketing Loan Program Payments.
>
> (2) The Panel ignored data indicating U.S. cotton production responds to market signals, namely, the relative price of cotton and other crops. Brazil countered that the Panel did indeed examine this factor.
>
> (3) The Panel neglected to examine supply responses, i.e., the extent to which other countries would increase their supply of cotton if U.S. cotton production fell because subsidies were cut or eliminated. Again, Brazil countered that the Panel accounted for this factor.

The Appellate Body ruled to the contrary. The record in the *Cotton* case showed that the Panel examined the four empirical points at paragraph 420.

At least one of the rationales provided by the Appellate Body for upholding the Panel's findings and justifications was predictable—lexicography. The data the Panel examined amply supported a finding of "significant price depression." This finding relied on the ordinary meaning of "significant," namely, "important, notable or consequential."[462] The Panel also properly availed itself of the discretion afforded to it by Article 6:3(c) of the SCM Agreement. This provision uses the term "effect" (not "cause"), which the *Shorter OED* defines as "something . . . caused or produced; a result or consequence."[463] Neither Article 6:3, nor Article 5, has precise, elaborate causation and non-attribution language. Therein lies a contrast with the trade remedy provisions of Part V of the SCM Agreement. Before imposing a countervailing duty (CVD), an examination is required of any known factors, other than subsidized imports, which contemporaneously injure the domestic industry. Nonetheless, the Panel rightly ensured that the effects of other factors on prices were not improperly attributed to the Price Contingent Subsidies.

A second reason was also predictable—precedent, albeit in this context in the broad sense. The Panel's non-attribution analysis fit within the fabric of Appellate Body Reports on causation decisions in the areas of anti-dumping and

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462. *See id.* ¶ 426.

463. *See Cotton* Appellate Body Report, *supra* note 404, ¶ 435.

safeguards.[464] In particular, the Appellate Body held in *U.S. – Hot Rolled Steel* that investigating authorities must "ensure that the injurious effects of the other known factors are not 'attributed' to dumped imports, [so] they must appropriately assess the injurious effects of those other factors."[465] The Panel's analysis in *Cotton* was consistent with two major safeguards cases, *U.S. – Wheat Gluten* (which held that causation "involves a genuine and substantial relationship of cause and effect" between increased imports and serious injury or threat),[466] and *U.S. – Line Pipe* (which said establishment of a causal link requires non-attribution of effects caused by other factors).[467] In effect, the Appellate Body's rationale was as follows:

> Even though Article 6:3(c) of the SCM Agreement does not mandate a non-attribution analysis in a price suppression inquiry, it is wise to engage in one if we are serious about the word "effect." This analysis is required before imposing a CVD, AD, or safeguard remedy, and some degree of harmonization of how to approach causation problems across trade remedies is sensible.

For yet a third reason, the Appellate Body found unpersuasive the U.S. claim that the Panel erred. Article 6:3(c) of the SCM Agreement is silent as to the sequence of steps to be followed in assessing whether a subsidy causes significant price depression. The Panel asked, first, whether there was "price suppression," second, whether the price suppression was "significant," and third, whether significant price suppression was the "effect" of the subsidy. While arranging the steps in the analysis differently may be appropriate, the order followed by the Panel hardly amounts to legal error. To the contrary, Article 6:3(c) confers upon panels some discretion in ordering its analysis.

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464. *See id.* ¶ 438 (citing *Hot Rolled Steel* Appellate Body Report, *supra* note 393; Appellate Body Report, *United States – Definitive Safeguard Measure on Imports of Wheat Gluten from the European Communities*, WT/DS166/AB/R (Dec. 22, 2000) [hereinafter *Wheat Gluten* Appellate Body Report]; Appellate Body Report, *United States – Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea*, WT/DS202/AB/R (Feb. 15, 2002) [hereinafter *Line Pipe* Appellate Body Report]).

465. *Hot Rolled Steel* Appellate Body Report, *supra* note 393, ¶ 223. This case is treated in Raj Bhala & David A. Gantz, *WTO Case Review 2001*, 19 ARIZ. J. INT'L & COMP. L. 457, 554-606 (2002).

466. *Wheat Gluten* Appellate Body Report, *supra* note 464, ¶ 69. This case is treated in Raj Bhala & David A. Gantz, *WTO Case Review 2001*, 19 ARIZ. J. INT'L & COMP. L. 457, 607-19 (2002).

467. *Line Pipe* Appellate Body Report, *supra* note 464, ¶ 208. This case is treated in Raj Bhala & David A. Gantz, *WTO Case Review 2002*, 20 ARIZ. J. INT'L & COMP. L. 144, 221-57 (2003).

Perhaps the most interesting feature of the swath of the Appellate Body Report dealing with causation is the treatment of a fourth argument raised by the United States concerning Panel error. The United States urged that the four bases on which the Panel held that Price-Contingent Subsidies have a price-suppressing effect do not cumulatively amount to causation. Whether this argument is properly a factual question or not, the Appellate Body treated it as a legal matter. Though it largely regurgitates and upholds the Panel's reasoning in favor of finding causation, the discussion is edifying to international trade lawyers and students seeking to understand how subsidies cause price depression, and, therefore, adverse effects that render them actionable under the SCM Agreement.

The first basis is the substantial proportionate influence of the United States in the world cotton market. The Appellate Body agreed it could not itself be conclusive evidence of a causal link. But, being a big player in the market surely increases the likelihood of price suppression caused by subsidies.

The second basis is the link between Price-Contingent Subsidies and world cotton prices. The further the world price falls, the larger the Marketing Loan Program payments, and thus the thicker the insulation for revenues of American cotton farmers. Likewise, Step 2 Payments stimulate domestic and foreign demand for U.S. cotton by eliminating any positive gap between domestic U.S. prices and international prices. Counter-Cyclical Payments and Market Loss Assistance Payments also are made in response to low market prices for cotton and stimulate U.S. cotton production by reducing the risk to total and per unit revenue associated with market price variability. Given the links between each Price-Contingent Subsidy and world market prices, it hardly came as a surprise that in MY 1999-2002, as market prices for U.S. cotton fell, cotton production and exports from the United States were stable or increased.

The third basis for the Panel's finding of a causal link is the temporal coincidence of suppressed world market prices and payment of the Price-Contingent Subsidies. The United States strongly countered that the Panel erred by engaging in an exercise of spurious correlation. The Appellate Body appreciated that correlation and causation are not the same, and offered the significant statement "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."[468] But, the Panel was right to consider it an important factor in the analysis.

The final basis offered by the Panel was a divergence, since 1997, between (1) the total cost of production and revenue for U.S. cotton farmers and (2) sales of cotton by these farmers. The United States argued that the Panel ought to have examined variable (not total) costs of production if it wanted to get a true picture of whether cotton farmers would have been economically capable of producing cotton without the Price-Contingent Subsidies. The Appellate Body acknowledged the importance of variable costs in the decision-making process as

468. *See Cotton* Appellate Body Report, *supra* note 404, ¶ 451.

to planting cotton versus an alternative crop and how much of each crop to plant. But, it said, in the long-run, total costs may be the relevant factor. It is unclear whether limited knowledge of farming or agricultural economics precluded the Appellate Body from a full explanation.[469] The Appellate Body seemed eager to spare itself with a conclusion that reliance on total costs did not amount to reversible error.

To its credit, the Appellate Body treated more carefully the other causal factors alleged by the United States to effect prices. These factors included (1) increases in textile imports into the United States (resulting in a decline in the use of cotton by domestic mills, and an increase in U.S. cotton exports between 1998-2002), (2) weakness in world cotton demand, (3) a strong US. dollar, and (4) release by China of government cotton stocks between 1999-2001. Some of them did have a price-suppressive effect. But the Appellate Body said the Panel had accounted for all of them and not attributed this effect to America's Price-Contingent Subsidies.

Was there any need for the Panel to quantify the price suppressive effect of these subsidies? "No," replied the Appellate Body. Just as Article 6:3(c) of the SCM Agreement does not specify an order of analysis, it does not demand quantification, nor does the definition of "subsidy" in Articles 1-2. That step in the examination is called for in GATT Article VI:3 and occurs under Part V of the Agreement, specifically, Article 19:4, when it comes time to calculate the amount of a CVD to be imposed. That amount is designed to offset an illegal subsidy and must not exceed it. Likewise, there is no need to allocate or expense to the year in which it is paid the price-suppressive effect of a recurring subsidy. The effect of a subsidy on prices may occur in subsequent years, that is, the repercussions of a subsidy paid annually are not extinguished annually.

#### iv. Export Subsidy Issues: Analysis of Appellate Body Holdings and Rationales

As suggested earlier, the Appellate Body Report does not differ significantly in rationale or conclusion on major substantive export subsidy issues from the Panel Report—with one key exception. The distinction is the dissenting opinion on the scope of Article 10:2 of the Agreement on Agriculture, with the dissent arguing the Panel and Appellate Body majority misread this provision by holding that it does not exempt export credit guarantees from the Article 10:1 disciplines on export subsidies. The Commentary Section (below) treats the dissenting opinion and urges that it is the stronger of the views.

469. *See id.* ¶ 453.

a) Step 2 Payments to Users as Red Light Import Substitution Subsidies[470]

The argument on which Brazil prevailed at the Panel stage also succeeded on appeal, namely, that Step 2 payments to U.S. cotton users are contingent on the use of American over imported cotton, thus fitting within the Red Light import substitution category of Article 3:1(b) of the SCM Agreement. The essence of the contingency is that payments are conditional on proof of consumption of domestically produced cotton. The United States did not contest that Step 2 payments are subsidies (i.e., financial contributions conferring a benefit to a specific enterprise or enterprises), nor that a user must open a bale of domestically produced baled cotton to get a payment. The United States also did not essay a Peace Clause defense, as Article 13 of the Agriculture Agreement was irrelevant to Brazil's claim under Article 3:1(b) of the SCM Agreement. Rather, the American defense was that Step 2 payments comply with U.S. domestic support reduction commitments under Article 6:3 of the Agriculture Agreement. In other words, the United States used the Agriculture Agreement as a shield against the sword of the SCM Agreement—because Step 2 payments to domestic users are permissible under the Agriculture Agreement, they do not violate the SCM Agreement.

The textual support for the American defense is the introductory clause in the *chapeau* to Article 3:1(b) of the SCM Agreement, Article 21 of the Agriculture Agreement, and Paragraph 7 of Annex 3 to the Agriculture Agreement. Entitled "Prohibition," Article 3 of the SCM Agreement provides: "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."

Article 21:1 of the Agriculture Agreement states: "The provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A [which includes the *SCM Agreement*] to the *WTO Agreement* [i.e., the *Agreement Establishing the World Trade Organization*] shall apply subject to the provisions of this *Agreement*."

Paragraph 7 of Annex 3 of the Agriculture Agreement is as follows: "The AMS [i.e., Aggregate Measure of Support] 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."[471]

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470. *See id.* ¶¶ 249(d)(i), 518-552, 763(d)(i).

471. Article 1(a) of the Agriculture Agreement defines AMS as:

> the annual level of support, expressed in monetary terms, provided for an agricultural product in favour of the producers of the basic

Using the first two texts, the United States sought to set up a conflict between the Agriculture and SCM Agreements, invoke the primacy of the former over the latter Agreement, and thereby exonerate Step 2 Payments. The *chapeau* to Article 3:1(b) clearly defers to the Agriculture Agreement. Further, as the Panel observed, Article 21:1 both acknowledges the application of GATT and the SCM Agreement to agricultural products, and says the Agriculture Agreement takes precedence in the event, and to the extent, of any conflict between it and any other Annex 1A accord.

As for the third text, the United States read it to create an exception to the Article 3:1(b) prohibition on import substitution subsidies. Unless Paragraph 7 to Annex 3 of the Agriculture Agreement is read to carve out from this prohibition payments to agriculture processors, the Paragraph serves no purpose. That is because if a domestic user, like an American textile mill, could get a Step 2 Payment regardless of the origin of cotton, U.S. or foreign, then the benefit to U.S. cotton producers would evaporate, and the Step 2 Payment scheme would change from a subsidy in favor of agricultural producers to an input subsidy. That is, the scheme would be not a cotton subsidy, but a textile subsidy.

The American defense hinged on two fundamental questions. First, in the *Cotton* case context, did the Agriculture and SCM Agreements conflict? Second, does Paragraph 7 of Annex 3 to the Agriculture Agreement say what the U.S. thinks? "No" was the answer to both questions.

The inference the United States drew from the introductory clause of the *chapeau* to Article 3:1(b) of the SCM Agreement and Article 21:1 of the Agriculture Agreement was a *non sequitur*. Drawing on these two textual provisions meant the United States was relying on yet another, and key, provision of the Agriculture Agreement, Article 6:3, which states:

> A Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule.

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> 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* . . . . Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Agriculture, annex 1A, Apr. 15, 1994, 33 I.L.M. 1125 (1994).

For a discussion of how AMS is calculated, including the exemptions from it for Blue Box and *De Minimis* Support, see generally Raj Bhala, *World Agricultural Trade in Purgatory*, 79 N.D. L. REV. 691 (2003) [hereinafter Bhala, *Purgatory*].

Article 6:3 does not excuse Red Light subsidies, be they import substitution subsidies or export subsidies. Rather, Article 6:3 caps the amount of domestic agricultural support a WTO Member can provide in keeping with its Uruguay Round commitments to cut progressively this support. In brief, Article 6:3 does not delineate permissible from forbidden types of support. Rather, it speaks only to permissible support and addresses whether the volume of that support is excessive. As the Panel explained, just because a subsidy program satisfies the Article 6:3 reduction commitment does not mean the program is lawful under the SCM Agreement, nor does it immunize the program from a claim that it is illegal under the SCM Agreement. The obligations under the Agriculture and SCM Agreements—to stay within reduction commitments and to eschew Red Light subsidies, respectively—are parallel obligations. Moreover, as the obligations are coherent and consistent, there is no conflict between the two accords, hence Article 21 of the Agriculture Agreement is inapplicable.

As for the third textual provision, the United States simply read Paragraph 7 to Annex 3 of the Agriculture Agreement wrongly. Nothing in it even intimates an exemption from the ban on Red Light import substitution subsidies, nor is its scope limited to support with an import substitution component. Further, even if Step 2 Payments were made to processors regardless of the origin of the cotton they used, they would still buy at least some American cotton. Consequently, U.S. cotton farmers would get some benefit from the measure. Contrary to the U.S. argument, the Paragraph refers to support for agricultural process that, in turn, benefit producers of a basic agricultural product.

The Appellate Body agreed wholeheartedly with the Panel's analysis. It rejected the American contention that the Panel failed to give meaning to the introductory phrase of Article 3:1(b) of the SCM Agreement, or that the Panel had rendered Paragraph 7 to Annex 3 of the Agriculture Agreement useless by refusing to limit its scope to import substitution subsidies. In attempting to use Article 6:3 of the Agriculture Agreement as a shield against an Article 3:1(b) claim, the United States stretched too far the meaning of Article 6:3. Rather, said the Appellate Body, Brazil correctly characterized matters: the obligations of the Agriculture and SCM Agreements apply cumulatively, unless there is an exception or conflict. But no inconsistency exists in this case. A WTO Member can—and plenty of them do—grant domestic support to farmers without making them contingent on domestic content.

With no stronger shield on appeal than before, the United States might have predicted the conclusion the Appellate Body would reach, namely, to uphold the finding of the Panel. Step 2 Payments to users are manifestly contingent on the use of American cotton. The United States admitted a domestic user must open a bale of domestically produced cotton in order to qualify for a subsidy. It had no other choice. The Payments are a textbook example of a *de jure* import substitution subsidy forbidden by Article 3:1(b) of the SCM Agreement, as Section 1207(a) of the FSRI Act of 2002 states the cotton must be "domestically produced," and "not imported," and expressly establishes use of the American cotton as a prerequisite for receipt of the subsidy.

b) Step 2 Payments to Exporters as Red Light Export Subsidies[472]

Brazil won at the Panel and Appellate stages with the same two-pronged argument against Step 2 Payments to exporters. They violate the Agriculture Agreement and SCM Agreement. Brazil's argument proceeded in accordance with the Appellate Body Compliance Report, *Canada – Dairy (Article 21:5 – New Zealand and U.S.)*.[473] In that case, the Appellate Body held the WTO-consistency of an export subsidy for an agricultural product must be examined, first, under the Agriculture Agreement, and second, if necessary, under the SCM Agreement.

This two-step method, however, does not preclude using the SCM Agreement for guidance to interpret the Agriculture Agreement. To the contrary, as the Appellate Body observed in the Compliance Report in the *Foreign Sales Corporation* case, the export contingency requirement in Article 3:1(a) of the SCM Agreement and Article 1(e) of the Agriculture Agreement is the same.[474] Likewise, Brazil successfully exploited the nearly identical language in Article 9:1(a) of the Agriculture Agreement and Article 3:1(a) of the SCM Agreement, namely, ("contingent on export performance"). The already-considerable jurisprudence on export subsidies under Article 3:1(a) was instructive, and there is no reason to interpret the phrase differently in the two Agreements. Additionally, Brazil took advantage of an irrebuttable presumption. If a measure fits in one of the two Red Light categories of the SCM Agreement (an Article 3:1(a) export subsidy, or an Article 3:1(b) import substitution subsidy), then there is no need to show it has an adverse effect.

First, Step 2 Payments for exporters easily fit on the list of export subsidies in Article 9:1(a) of the Agriculture Agreement, because (in the words of that Article), they are "contingent on export performance." Article 9:1(a) speaks of "the 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

472. *See Cotton* Appellate Body Report, *supra* note 404, ¶¶ 249(d)(ii), 553-584, 763(d)(ii).

473. *See* Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Recourse to Article 21:5 of the DSU by New Zealand and the United States*, WT/DS103/AB/RW, WT/DS113/AB/RW, ¶ 123 (Dec. 3, 2001); *Cotton* Appellate Body Report, *supra* note 404, ¶ 570.

474. *See* Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21:5 of the DSU by the European Communities*, WT/DS108/AB/RW, ¶ 192 (Jan. 14, 2002) [hereinafter *Tax Treatment* Appellate Body Report]; *Cotton* Appellate Body Report, *supra* note 404, ¶ 571.

board, contingent on export performance . . . ." Article 9:1(a) is relevant because Article 1(e) of the Agriculture Agreement references it. Article 1(e) defines "export subsidies" as "subsidies contingent upon export performance, including the export subsidies listed in Article 9 of the Agreement." What does "contingent" mean?

The ordinary meaning, which the Appellate Body noted in its Report in the *Canada – Aircraft* case,[475] and its Compliance Report in that case, *Canada – Aircraft (Article 21.5 – Brazil)*,[476] is "conditional," "dependent," or "tied to." Thus, any relationship of this nature between the granting of a subsidy and export performance is an export subsidy under Article 3:1(a) of the SCM Agreement and under Article 9:1(a) of the Agriculture Agreement. Without doubt, that relationship exists as regards Step 2 Payments to exporters. The authorizing legislation, Section 1207(a) of the FSRI Act of 2002, expressly conditions receipt of payment on proof of exportation of American cotton. It says support is available to "exporters" for "sales for export by exporters," and in order to claim a Payment, an exporter must submit an application and supporting documentation, including proof of export, to the CCC. There could hardly be a closer tie between payment and exportation. Thus, held the Panel and Appellate Body, the Payments are inconsistent with Articles 3:3 and 8 of that Agriculture Agreement.

The second prong of Brazil's argument against Step 2 Payments to exporters invoked the SCM Agreement. They are *per se* illegal, because they are *de jure* Red Light export subsidies under Article 3:1(a) of the SCM Agreement. This provision states:

> Except as provided in the *Agreement on Agriculture*, the following subsidies, within the meaning of Article 1, shall be prohibited:
>
> > (a) subsidies contingent, in law or in fact,[4] whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I;[5]
> >
> > ---
> >
> > [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

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475. *See* Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, ¶ 179 (Aug. 2, 1999); *Cotton* Appellate Body Report, *supra* note 404, ¶¶ 574, 578, 582.

476. *See* 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, ¶ 47 (July 21, 2000); *Cotton* Appellate Body Report, *supra* note 404, ¶¶ 574, 578, 582.

> 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*.

If Step 2 Payments are contingent on export performance under the Agriculture Agreement, then so too are they under the above-quoted provision. "Indeed," replied the Appellate Body, albeit with considerably more words than one.

To the *Cotton* Panel and Appellate Body, the ¶ 192, made the same losing argument: Step 2 Payments are not export subsidies, because they are available not only to exporters, but also to domestic users of American cotton. That this argument, summarized by the phrase "the subsidy is export-neutral because it is available in both circumstances," would be unsuccessful was predictable. That is because it was conceptually no different from the unsuccessful American defense of the Extraterritorial Income Act (ETI Act) in *U.S. – Foreign Sales Corporation (Article 21:5 – EC)*.[477] The ETI Act was the Clinton Administration's effort to comply with the adverse Appellate Body decision in the *Foreign Sales Corporation* case. The European Communities (EC) charged the ETI Act (like its predecessor) still provided an export subsidy. The Appellate Body agreed, ruling in the Compliance Report, *U.S. – Foreign Sales Corporation (Article 21:5 – EC)*, that an expansion of the universe of potential beneficiaries beyond exporters does not negate the reality that an export subsidy exists:

> 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." 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. 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:

477. *See Tax Treatment* Appellate Body Report, *supra* note 474, ¶¶ 110, 115, 119-120.

> > Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances [property produced in the U.S. and held for use outside the U.S.] is not affected by the fact that the subsidy can also be obtained in the second set of circumstances [property produced outside the U.S. and held for use outside the U.S.]. 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.
>
> 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. 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."[478]

In brief, to pass muster as a lawful subsidy, an export contingency must be dissolved entirely, not merely diluted by broadening the beneficiaries to include non-exporters.

Indubitably, the United States was aware of the adverse precedent from the *Foreign Sales Corporation* case. It repeated the argument, however, because it said the facts in the *Cotton* case were distinguishable from the facts in *Foreign Sales Corporation*. They were akin to the facts in *Canada – Dairy*.[479] Thus, to be fair to the U.S. argument, it followed old-fashioned legal advice of arguing facts when facts are favorable and law is not. The problem for the United States, however, was the facts were as unfavorable as the law. Further, the lawyers for Brazil—a civil law country—proved every bit as adept, even more so, than their common law counterparts at distinguishing factual and legal situations.

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478. *Cotton* Appellate Body Report, *supra* note 404, ¶¶ 579-580.

479. *See* Panel Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/R, WT/DS113/R, ¶¶ 7.41, .124 n.496 (May 17, 1999) (modified by the Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/AB/R, WT/DS113/AB/R (Oct. 13, 1999)); *Cotton* Appellate Body Report, *supra* note 404, ¶ 581.

In *Canada – Dairy*, the complainants argued providing milk to exporters and processors, through various mechanisms called "special milk classes," was an export-contingent subsidy. The Panel in that case held the special milk classes were not export-contingent because the milk also was available, often exclusively, to processors which produce for the Canadian market. However, the relevant Canadian legislation and regulations did not have an explicit condition limiting a segment of the payments of subsidies to exporters. The Step 2 Payments legislation clearly delineated two sets of recipients—eligible domestic users and eligible exporters. Moreover, the special milk classes were a single regulatory category of milk, and there was one set of conditions, not two, for payment. The Step 2 Payments scheme had two such categories with distinct requirements—support for users who opened a bale of American cotton, and support for exporters who proved they exported American cotton.

#### c) Export Credit Guarantees as Red Light Export Subsidies[480]

The last major substantive issue on appeal in the *Cotton* case was whether the three American Export Credit Guarantee programs—GSM 102, GSM 103, and SCGP—were illegal. This issue, like the matter of the legality of Step 2 Payments to exporters, is pedagogically useful and technically intriguing because it demonstrates the relationship and interaction of the SCM and Agriculture Agreements. Agreeing with Brazil, the Panel found they were *per se* unlawful under Article 3:1(a) of the SCM Agreement, i.e., they were Red Light export subsidies.

The Panel's finding depended on two legal interpretations under the Agriculture Agreement. First, Article 10:2 of the Agriculture Agreement does not exempt the Export Credit Guarantees from the disciplines of Article 10:1 of that Agreement. These provisions state:

> 1. 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.
> 2. 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

480. *See Cotton* Appellate Body Report, *supra* note 404, ¶¶ 249(e)(i), (iii)-(iv), 585, 590-630, 763(e)(i), (iii)-(iv).

in conformity therewith.

Brazil also charged that the Export Credit Guarantees violate Article 8 of the Agriculture Agreement, which states "[e]ach Member undertakes not to provide export subsidies otherwise than in conformity with this *Agreement* and with the commitments as specified in that Member's Schedule." The second legal interpretation concerns the Peace Clause. Because the Guarantees are not exempt from the Article 10 disciplines, and violate Article 8, they are not entitled to immunity under Article 13(c)(ii) of the Agriculture Agreement. In turn, without the immunity, the Guarantees are vulnerable to challenge under the SCM Agreement.

The Panel's finding also relied on the SCM Agreement to categorize the Guarantees as an "export subsidy." Neither the Agriculture Agreement nor SCM Agreement explains precisely what an "export subsidy" is, in the sense of defining when a subsidy is "contingent on export performance." Article 1(e) of the Agriculture Agreement has a general definition of "export subsidies," namely, "subsidies contingent upon export performance, *including* the export subsidies listed in Article 9 of this *Agreement*" (emphasis added). Brazil argued Article 1(e) encompasses export credit guarantees, and thus places them within the scope of the Article 10:1 disciplines, and, Article 10:2, which establishes two obligations, but no exceptions, does not remove them from this scope.

Moreover, as referenced in Article 1(e), Article 9:1 of the Agriculture Agreement sets out a non-exhaustive list of export subsidies. Significantly, Brazil and the United States stipulated that export credit guarantees are not included on the Article 9:1 list. Entitled "Export Subsidy Commitments," Article 9:1 of the Agriculture Agreement states in full:

> 1. The following export subsidies are subject to reduction commitments under this *Agreement*:
>
> (a) the 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;
>
> (b) the sale or disposal for export by governments or their agencies of non-commercial stocks of agricultural products at a price lower than the comparable price charged for the like product to buyers in the domestic market;
>
> (c) payments on the export of an agricultural product that are financed by virtue of governmental action, whether or not a charge on the public account is involved, including payments that are financed from the

proceeds of a levy imposed on the agricultural product concerned or on an agricultural product from which the exported product is derived;

(d) the provision of subsidies to reduce the costs of marketing exports of agricultural products (other than widely available export promotion and advisory services) including handling, upgrading and other processing costs, and the costs of international transport and freight;

(e) internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favourable than for domestic shipments;

(f) subsidies on agricultural products contingent on their incorporation in exported products.

2.

(a) Except as provided in sub-paragraph (b), the export subsidy commitment levels for each year of the implementation period, as specified in a Member's Schedule, represent with respect to the export subsidies listed in paragraph 1 of this Article:

(i) in the case of budgetary outlay reduction commitments, the maximum level of expenditure for such subsidies that may be allocated or incurred in that year in respect of the agricultural product, or group of products, concerned; and

(ii) in the case of export quantity reduction commitments, the maximum quantity of an agricultural product, or group of products, in respect of which such export subsidies may be granted in that year.

(b) In any of the second through fifth years of the implementation period, a Member may provide export subsidies listed in paragraph 1 above in excess of the corresponding annual commitment levels in respect of the products or groups of products specified in Part IV of the Member's Schedule, provided that:

(i) the cumulative amounts of budgetary outlays for such subsidies, from the beginning of the implementation period through the year in question, does not exceed the cumulative amounts that would have resulted from full compliance with the relevant annual outlay commitment levels specified in the Member's

> > Schedule by more than [three] per cent of the base period level of such budgetary outlays;
> >
> > (ii) the cumulative quantities exported with the benefit of such export subsidies, from the beginning of the implementation period through the year in question, does not exceed the cumulative quantities that would have resulted from full compliance with the relevant annual commitment levels specified in the Member's Schedule by more than 1.75 per cent of the base period quantities;
> >
> > (iii) the total cumulative amounts of budgetary outlays for such export subsidies and the quantities benefiting from such export subsidies over the entire implementation period are no greater than the totals that would have resulted from full compliance with the relevant annual commitment levels specified in the Member's Schedule; and
> >
> > (iv) the Member's budgetary outlays for export subsidies and the quantities benefiting from such subsidies, at the conclusion of the implementation period, are no greater than [sixty-four] per cent and [seventy-nine] per cent of the 1986-1990 base period levels, respectively. For developing country Members these percentages shall be [seventy-six] and [eighty-six] per cent, respectively.
>
> 3. Commitments relating to limitations on the extension of the scope of export subsidization are as specified in Schedules.
>
> 4. During the implementation period, developing country Members shall not be required to undertake commitments in respect of the export subsidies listed in sub-paragraphs (d) and (e) of paragraph 1 above, provided that these are not applied in a manner that would circumvent reduction commitments.

However, because the list is not exclusive, would it be too strong an inference to say "the Article 10:1 disciplines on export subsidies are inapplicable to export credit guarantees because these guarantees are not on the Article 9:1 list?" For two reasons, the Panel and two Appellate Body members thought so.

First, the first clause of Article 10:1 (a maddening double negative) carves out from its disciplines only one kind of export subsidy—export subsidies listed in Article 9:1 of the Agriculture Agreement. (Stated in the affirmative, if an export subsidy *is* listed in Article 9:1, then it is exempt from the anti-circumvention obligations of Article 10:1). Because of the Brazilian-American stipulation, the disputed guarantees were not on the list. Hence, they were not exempted under the first clause.[481] This plain-meaning logic is the strongest point in favor of the majority view.

Second, the Panel and Appellate Body majority turned to Annex I of the SCM Agreement. This Annex, entitled "Illustrative List of Export Subsidies," offers guidance relevant to the interpretation of the term "export subsidy" as used in Article 10 of the Agriculture Agreement. Of particular relevance is Item (j) on the List, which deals with guarantee provided at premium rates inadequate to cover long-term operating costs and losses of the guarantee programs. Item (j) states:

> The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programs, of insurance or guarantee programs against increases in the cost of exported products or of exchange risk programs, at premium rates which are inadequate to cover the long-term operating costs and losses of the programs.

Brazil urged, and the Panel and two Appellate Body members agreed, that the American Export Credit Guarantees fit within Item (j). Consequently, they believed it was appropriate to apply Article 10:1 of the Agriculture Agreement to these Guarantees.

Manifestly, Article 10:2 mentions export credit guarantees, as well as export credits and insurance programs. The two obligations it creates are to construct disciplines on these measures, and to abide by the disciplines once they are in place. But, Article 10:2 does not expressly exempt these measures from the existing disciplines of Article 10:1 in the *inter regnum*. If the Uruguay Round negotiators had intended to carve out these measures from the Article 10:1 duty not to circumvent export subsidy commitments, then they would have explicitly revealed that intention in the text of Article 10:1 or 10:2.

The whole point of Article 10, reasoned the Panel and two-member Appellate Body majority, is to prevent circumvention of export subsidy commitments by establishing specific, binding rules for export competition. The title of the Article is "Prevention of Circumvention of Export Subsidy Commitments." The U.S. position would leave WTO Members free to grant unlimited export subsidies, in the form of export credit guarantees, and thus circumvent those commitments. Put succinctly, the Americans would have export credit guarantees completely unregulated until a WTO consensus is reached on disciplines.[482] That may be true, but it is a fact of life in many international trade negotiations. The majority's statement—"[w]e find it difficult to believe that the

481. *See id.* ¶¶ 614-615.
482. *See id.* ¶ 617.

[Uruguay Round] 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 circumvent a WTO Member's export subsidy reduction commitments"[483]—suggests the majority substituted its preference for a historical negotiating outcome.

The United States offered a powerful rebuttal to the Brazilian argument and Panel holding. Article 10:2 makes it clear that export subsidy disciplines in both the Agriculture and SCM Agreements are inapplicable to export credit guarantee programs. As a legal matter, the United States had the better argument, but it persuaded only one of the Appellate Body members (who filed a dissent, which is discussed in the Commentary below). The essence of the American argument was that during the Uruguay Round negotiators did not agree to put disciplines on agricultural export credits, export credit guarantees, and insurance programs. The negotiators made a deliberate decision not to include export credit guarantees, export credits, and insurance programs in Article 9:1 of the Agriculture Agreement. Rather, they opted to continue negotiations, and defer imposition of any obligations until a consensus is reached:

> 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*." 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."[484]

Thus, until a bargain on export credits is reached, possibly in the Doha Round, the GSM 102 and 103 Programs, and SCGP, are not subject to Article 10:1 scrutiny. Further, by virtue of Article 21:1 of the Agriculture Agreement, these Programs also are not subject to the export subsidy disciplines of the SCM Agreement.

The American rendition of the history was accurate, as adduced by documents from the Uruguay Round. Further, it would be illogical for the negotiators of that Round to subject Amber Box subsidies to Article 6 reduction commitments, and to include export credits, guarantees, and insurance programs, but not also include them as part of the AMS calculation for the reduction

483. *Id.*
484. *Id.* ¶ 622.

commitments. Why would the negotiators have treated these measures as already disciplined export subsidies, but not permitted them to be included in the reduction commitments? (Brazil's reply to this question was that the United States took a calculated risk when it steadfastly refused to consider its export credit guarantees as export subsidies, and decided not to include them in its Article 9 reduction commitments.) Moreover, the United States observed, the actions of WTO Members speak volumes. No Member had reported export credit guarantees in its schedule of commitments concerning export subsidy cuts.

Nevertheless, the Appellate Body rejected the American version of Uruguay Round history and its implications:

> 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*. The Panel did not think it necessary to resort to negotiating history for purposes of its interpretation of Article 10.2. Even if the negotiating history 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.

As for why no Member has reported in its schedule export credit guarantees as an export subsidy, the Appellate Body said "[t]here could have been several reasons .

. . ."[485] The Appellate Body proceeded to give just one explanation: maybe they thought their particular export credit guarantee, export credit, or insurance program was free of any subsidy component, so the measure was not subject to export subsidy commitments.

Well, maybe. Evidently, the Appellate Body was more comfortable resting on its own speculation than on the logic articulated by the United States and the practice of the Members. The Appellate Body concluded by holding:

> 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*.[486]

In brief, the Appellate Body drew a far weaker inference than the United States from the decision of Uruguay Round negotiators to exclude from the list of export subsidies in Article 9:1 express mention of export credit guarantees, export credits, and insurance programs.

In so doing, the Appellate Body made matters far more complicated than the text of the Agriculture Agreement suggests. At bottom, the regulatory scheme for export subsidies in Article 9 and 10 is not Byzantine. Article 9:2 creates

485. *Cotton* Appellate Body Report, *supra* note 404, ¶ 625.
486. *Id.* ¶ 626.

reduction commitments for export subsidies listed in Article 9:1. Article 10:1 deals with export subsidies not listed in Article 9:1. The two provisions are mutually exclusive, and taken together, cover the universe of export subsidies—with the major exception of programs covered by Article 10:2. If a particular export subsidy is not listed in Article 9:1, then it must be covered by Article 10:1, or be exempt under Article 10:2. The obligation in Article 10:1 is to eschew circumvention of export subsidy commitments in Article 9. (Though it split the infinitive, the dissent rightly put it: "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."[487])

In effect, Article 10:1 preserves the integrity of these commitments. It anticipates that an unscrupulous or naïve WTO Member might create an export subsidy program that is not on the Article 9:1 list, and that non-listed program might undermine the Member's Article 9:2 reduction commitments. As for Article 10:2, it essentially proclaims the types of export subsidy programs on which there has been no consensus—either as to reducing their value and volume under Article 9:2, or as to imposing the anti-circumvention rule of Article 10:1.

The Appellate Body would have done the world trading community a service (which, admittedly, is not its express mandate) if it had provided a simple tutorial on how Articles 9-10 work.[488] It might also have saved itself from the dissent. Put differently, the Appellate Body would have realized the Americans got this one right—Article 10:2 does exempt export credit guarantees like the GSM 102 and 103, and SCGP measures from the discipline of Article 10:1.

The United States had a fallback argument. Even if the export subsidy disciplines of the Agriculture and SCM Agreements cover export credit guarantee programs, Article 3:1(a) of the SCM Agreement does not prohibit the particular American measures—GSM 102 and 103, and SCGP—at issue. These measures do not satisfy the criteria for inclusion in Item (j) of Annex I to that Agreement. The Appellate Body rather easily, though erroneously, upheld the Panel's contrary finding, and ruled the measures are *per se* illegal Red Light Export subsidies. The Appellate Body offered two rationales: the first logical, and the second quantitative.

First, said the Appellate Body, the American argument is premised on the proposition that Article 10:2 of the Agriculture Agreement exempts export credit guarantees from the export subsidy disciplines of that Agreement. Because the Appellate Body found the American proposition meretricious, it rejected the fallback contention.[489] Second, the Appellate Body upheld the Panel's analysis that the premiums associated with the disputed American measures are inadequate to cover the long-term operating costs and losses of the U.S. export credit

487. *Id.* ¶ 635.

488. *See* Bhala, *Purgatory*, *supra* note 471, at 809-20.

489. *See Cotton* Appellate Body Report, *supra* note 404, ¶¶ 629-630.

guarantee programs.[490] Thus, the measures fit within Item (j) of the Illustrative List of Export Subsidies annexed to the SCM Agreement. In seventeen rather tedious paragraphs, the Appellate Body explained that regardless of the calculation methodology applied—Net Present Value (favored by the United States), Cost (i.e., Cash Basis Accounting, favored by Brazil), or Fiscal Year/Cash Basis (using U.S. data)—the premiums charged by the United States could not possibly cover long-term costs and losses.

Food aid was a final, interesting—but, ultimately, unpersuasive—consequentialist argument the United States made. The United States said international food aid is, and should be, excluded from coverage under the Agriculture Agreement. But, under the expansive approach of Brazil and the Panel to Article 10:1 of the Agreement, it is subject to the full array of export subsidy disciplines. That is because Article 10:1 does not expressly exclude food aid (as it does not expressly exclude export credit guarantees). Moreover, said the United States, food aid would be subject to a second set of disciplines, namely, the ones set forth in Article 10:4 of the Agreement. Article 10:4 states:

> Member 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.

In turn, said the United States, food security in developing and least developed countries would be adversely affected, and surely the drafters of the Agreement did not intend this consequence.

Well-intentioned as the American argument might have been, the Appellate Body rejected it. It replied that Article 10:4 does not exclude international food aid from the scope of Article 10:1. Rather, this aid is covered by the second clause of Article 10:1, at least to the extent the aid is a "non-commercial transaction." Article 10:4, then, ensures food aid is not used to circumvent the commitments a WTO Member makes on export subsidies. In

490. *See id.* ¶¶ 658-674.

other words, a WTO Member is free to grant as much food aid as it wishes, as long as it does so consistently with Articles 10:1 and 10:4.

### 3. Commentary

#### a. Poor Writing, Translation, and Legal Capacity

The *Cotton* Appellate Body Report spans 295 printed pages (8 ½ by 11 inch size). It contains 1192 footnotes. One way to wade through the endlessly redundant and dreadfully dull style in one sitting is to be in a temporarily inescapable space until completion. (The author of this portion of the *WTO Case Review 2005* did just that, reading it on the world's longest commercial flight, on Singapore Airlines from Newark to Singapore—a non-stop journey of 18.5 hours.) It becomes readily apparent that the Report desperately needs careful editing.

The most obvious example of redundancy is Part II of the Report. It contains the arguments of the complainant, respondent, and third party participants. All of the arguments of the complainant and respondent are presented again in Parts IV (concerning preliminary issues), V (concerning domestic support), VI (concerning serious prejudice), and VII (concerning import substitution and export subsidies). Indeed, the presentations in the later parts are easier to follow, and more pointedly presented, than in Part II. Put bluntly, Part II mindlessly regurgitates what the parties said in writing or orally, whereas the Appellate Body synopsizes their arguments nicely in Parts IV-VII. The Appellate Body would have done better to drop Part II entirely, which would have cut out seventy-two pages from its Report (pages 8-84) encompassing 238 paragraphs (paragraphs 10-248).

The well-known reason against deleting a dedicated portion on arguments is participants like to know judges understood and took their points into account. "Poppycock" is the obvious response. Judges show they do so by weaving these arguments into the appropriate points in their decision. That is also true for third party argumentation, though there is a question whether third parties have a legitimate right to expect full treatment of their views.[491] A second rationale is that international legal opinions traditionally contain a restatement of the arguments of the parties. Here, the obvious response is that if a tradition is needlessly inefficient, it should be abandoned. A third rationale is that a separate section might help teach WTO Members how to litigate cases, because they can examine the separate argumentation section. But there is an obvious response.

491. The *Cotton* case attracted an eclectic bunch of third parties. Two of the Cotton 4 countries – Benin and Chad (but not Burkina Faso or Mali) filed a joint third party submission, and Argentina, Australia, Canada, China, the EC, and New Zealand filed separate submissions. India, Pakistan, Paraguay, Taiwan, and Venezuela appeared at the oral arguments. The participation of China and Taiwan is particularly notable. *See id.* ¶ 7.

They can pursue that study by reading in the context of the holdings and rationale. Indeed, for didactic purposes, it may well be preferred to see the arguments juxtaposed with those holdings and rationale than to read them *in vaccuo*.

Why bother about editing Appellate Body decisions? The short answer is "because they matter." Poor writing style is about more than style, especially if the writing has important consequences for the world. In Appellate Body cases, a written opinion has implications for legal capacity development, and the requirement of translating reports may interfere with this development. In a candid passage, the Appellate Body stated it could not issue the *Cotton* Report within the normal ninety-day period called for by DSU Article 17:5.[492] One reason was the complexity of the issues, which increased the burden on both the Appellate Body and the WTO translation services. A second reason was the unavailability of those services during a WTO holiday period. These reasons might also suggest an (but not the only, or even the major) explanation for the poor writing style, namely, the requirement of translation into French and Spanish.

As any good writer knows, it takes more time to write less, and less time to write more. (The author of this portion of the *Review* readily confesses to learning the lesson the hard way.) Why take precious time away from editing the draft Report in the original language in which written and oral proceedings are conducted, and in which the draft is written, to translate the document into French and Spanish? Why, indeed, when the language of international law and business is English, and the second-language of choice for most non-native English speakers is English? (It cannot go unnoticed that two of the three Appellate Body members, Luiz Olavo Baptista and A.V. Ganesan, but not Merit E. Janow, in the *Cotton* case are not from English-speaking countries, yet they conducted the case—like all WTO adjudicatory proceedings—predominantly in English.) Why, indeed, when linguistic trends manifestly show the far greater importance of Mandarin Chinese or Hindi, or no less importance of Arabic?

The answer to these questions is that the requirement that French and Spanish be official languages at the WTO along with English is outdated. Hence, the WTO Secretariat maintains a giant Translation Division, and every Appellate Body Report—and every other WTO document—needs shifting into the other two languages. Theoretically, offering every document in French and Spanish ought to help expand legal capacity in French-speaking West Africa or Spanish-speaking Central and South America. That theory presumes that the document translated makes sense and has pedagogical value for officials from these countries. When the work translated is Hegel's *Phenomenology of Spirit*, it does not become any easier in the next language. Rewriting the text in the *lingua franca* of the profession, and then translating it if need be, would be more helpful to the readers trying to learn about international trade law (or philosophy).

In law and economics terms, the poor quality of writing in the *Cotton* case is an externality of translation. It is a cost of translation not directly built into

492. *See id.* ¶ 8.

the cost-benefit calculation of translating documents into French and Spanish. This externality is high, and should be of concern to all WTO Members, because of the link to legal capacity.

As followers of the Doha Round appreciate, cotton subsidies are a poignant example of the major agricultural issues facing WTO Members. Failure to resolve the demands of the Cotton 4 Countries—Benin, Burkina Faso, Chad, and Mali—helped doom the September 2003 Cancún Ministerial Conference, and the progress on the topic in the December 2005 Hong Kong Ministerial Conference was somewhere between limited and insulting (depending on one's perspective). Understanding the important rulings in the *Cotton* case contributes to the legal capacity of individual delegates to these Conferences. How many of these delegates have the time, inclination, or patience to read a 295-page document to improve their ability to participate in Doha Round negotiations? For English-speaking international trade lawyers, the challenge is steep. It is an almost vertical incline for non-native speakers, or for newcomers to the world of international trade law. The same questions apply to non-governmental organization (NGO) officials. Their critics fault some of them for unfairly accusing developed country WTO Members of selfishness, and the WTO of protecting the interests of the rich Members. Yet a document like the *Cotton* Report hardly is going to help NGO officials working on shoestring budgets to improve their own legal capacity so they, in turn, can give counsel to poor countries that is both wise and technically accurate.

To be sure, the requirement of translation into French and Spanish is not the only cause—maybe not even the substantial cause—of poor writing in Appellate Body decisions. Further, no one—neither law professors nor Appellate Body members—is a perfect writer. The point is to posit a direct relationship between writing quality and legal capacity: the better the writing, the easier it is to build the skill set necessary for effective participation in the WTO system. As for translation, the question is whether focusing production of judicial decisions in the preeminent international trade language might contribute to a shorter, clearer, more engaging writing style, and in turn yield documents that could help build legal capacity among WTO Members and NGOs. Asked differently, at present trends, in a decade or less, will the world trading community find Appellate Body documents to be accessible to all, but comprehensible only to a select legal priesthood defined by grit and stamina?

#### b. Judicial Conservatism

In the increasingly global debate, which is especially heated in the United States, about whether the Appellate Body is guilty of judicial activism that leads to infringement on sovereignty, a number of difficulties are encountered. One problem is whether judicial activism is something about which a tribunal ought to feel guilty. There are cases when justice cries for moving beyond cold dictionaries and dry texts. Moreover, as any schooled critic of Islamic fundamentalism knows, to close the door to independent reasoning (*ijtihad*) is to doom a legal system to ossification and all the dangerous and oppressive consequences that come with it. Another problem is whether a bit of infringement on sovereignty might be a good thing. Progressive trade liberalization sometimes requires a bit of external discipline. It may be welcomed (privately) if it can be used to persuade recalcitrant reformers to budge. Still another matter is whether the Appellate Body is as judicially active as some fusspots claim.[493]

That claim is incredulous, at first glance, because of the large and increasing number of Appellate Body rulings that stick to the narrow terms of a text as the *OED* defines those terms. A court rarely straying beyond its dictionary is not disposed to *ijtihad*. Consider three further examples of the *Cotton* Appellate Body Report that show more than a judicially conservative orientation redolent of opinions of U.S. Supreme Court Justice Antonin Scalia. They even suggest the United States pushed the Appellate Body toward judicial activism.

The first two examples concern the ruling against the United States, namely, Production Flexibility Contract Payments and Direct Payments are not entitled to Green Box treatment and thus not immunized by Article 13(a) of the Peace Clause. First, the final rationale the Appellate Body offered in support for its interpretation of Paragraph 6(b) of Annex 2 to the Agreement on Agriculture was to contrast it with Paragraph 11 of the same Annex.[494] Paragraph 11 concerns

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493. *See, e.g.*, Daniel K. Tarullo, *The Hidden Costs of International Dispute Settlement: WTO Review of Domestic Anti-Dumping Decisions*, 34 LAW & POL'Y INT'L BUS. 109 (2002) (concerning respect, or the lack thereof, for standards of review).

494. *See Cotton* Appellate Body Report, *supra* note 404, ¶¶ 335-338. This provision states:

> 11. Structural adjustment assistance provided through investment aids.
>
> (a) Eligibility for such payments shall be determined by reference to clearly-defined criteria in government programmes designed to assist the financial or physical restructuring of a producer's operations in response to objectively demonstrated structural disadvantages. Eligibility for such programmes may also be based on a clearly-defined government programme for the reprivatization of agricultural land.
>
> (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 other than as provided for under criterion (e) below.
>
> (c) The amount of such payments in any given year shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period.

structural adjustment assistance provided through investment aids, so that farmers may restructure their financial or physical operations. Paragraphs 11(b) and (e) expressly authorize a negative requirement not to produce agricultural products in exchange for payments. The express permission indicates that the drafters of the Agreement were aware of negative requirements, and of their ability to write into the Agreement an explicit authority for them. The Appellate Body explained that the drafters could have expressly authorized such requirements in Paragraph 6(b), as they did in Paragraphs 11(b) and (e). Manifestly, from the text of Paragraph 6(b), the drafters did not do so. The U.S. argument called for judicial activism, namely, that the Appellate Body should hold that the drafters implicitly authorized negative requirements in Paragraph 6(b).

Second, on the same topic, the United States offered a plausible argument for why the Appellate Body should overrule the Panel and permit negative reduction requirements like production flexibility limitations as part of some Green Box measures. How could a WTO Member create a decoupled income support scheme that qualifies for the Green Box, but also excludes illegal crops like opium poppy, unapproved biotech varieties, or environmentally damaging products?[495] The Member would have to exclude these crops, but under the Panel's holding this exclusion would take the scheme out of the Green Box. This reasoning, by the admission of the Appellate Body itself, is consequential in nature. In quintessential lawyer-like fashion, the United States invited the Appellate Body to consider the logical consequence of the Panel's holding as an undesirable public policy.

The Appellate Body rejected the American invitation. Staying with the text of Paragraph 6(b), the Appellate Body said the plain language would not bar exclusion of illegal products, because "production" refers to "lawful production." It is true (as the Appellate Body observed) that Article 6:2 of the Agriculture Agreement exempts from domestic support reduction commitments any measure by a developing country to deal with narcotic crops, as well as environmental measures. But, is the declaration of the Appellate Body more of an assertion borne of a desire to be conservative than a textually grounded argument? To read "production" as "lawful production" seems to be a move that helped the Appellate Body avoid consequential, public-policy considerations.

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> (d) The payments shall be given only for the period of time necessary for the realization of the investment in respect of which they are provided.
> (e) The 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.
> (f) The payments shall be limited to the amount required to compensate for the structural disadvantage.

*Id.*

495. *Id.* ¶¶ 339-340.

The third example concerns the interpretation of GATT Article XVI:3.[496] The phrase "any form of subsidy which operates to increase the export" appears in GATT Article XVI:3. What is the scope of this phrase? The Panel held Article XVI:1 and 3 are distinct, and do not jointly apply to domestic support and export subsidies. In particular, Article XVI:3 "applies only to export subsidies as that term is now defined in the *Agreement on Agriculture* and the *SCM Agreement*."[497] Brazil challenged this definition, saying Article XVI:3 is not limited to subsidies contingent on export performance, but rather is concerned with any measure that enhances exports.

Brazil relied on the ordinary meaning of the language of the second sentence of Article XVI:3 (concerning "any form of subsidy which operates to increase the export of any primary product"), inferring from it a discipline on any subsidy with an export-enhancing effect, whether or not the subsidy is export-contingent. The American response was that the definition of "export subsidy" in the Agriculture and SCM Agreements refers to subsidies contingent on export performance, and this definition applies to Article XVI:3, because of the context and negotiating history of the Agreements.

In one of the few (if not only) substantive victories in the case, the United States prevailed at the Panel stage.[498] However, the Appellate Body found it unnecessary to issue a ruling, and neither upheld nor reversed the Panel's definition.[499] Significantly, the Appellate Body was taciturn even though it appreciated that a finding would be "useful" in future cases. To justify its inaction, it cited the *U.S. – Steel Safeguards* case, in which it refused to provide guidance on causation, even though several participants in that case said it would be helpful to get direction from the Appellate Body. In these instances, at least, the Appellate Body hardly showed the stuff of judicial activism.[500]

### c. Precedent and Memory

The use of precedent was the most noteworthy feature of the stamp "Affirmed" that the Appellate Body affixed to the portion of the Panel Report dealing with Step 2 Payments to domestic users. First, the Appellate Body smilingly recounted Brazil's citation to an early GATT Panel Report, *Italy –*

496. *See id.* ¶¶ 249(h), 749-762, 763(h).

497. *See id.* ¶ 751 (quoting *Cotton* Panel Report, *supra* note 404, ¶ 7.1016).

498. *See id.* ¶¶ 753-755.

499. *See Cotton* Appellate Body Report, *supra* note 404, ¶¶ 761-762.

500. Brazil also urged the Appellate Body to find that the four Price-Contingent Subsidies (Counter-Cyclical Payments, Market Loss Assistance Payments, Marketing Loan Program Payments, and Step 2 Payments) caused the United States to have "more than an equitable share of world export trade" in cotton, thus violating Article XVI:3. The Appellate Body declined to rule on this matter. *Cotton* Appellate Body Report, *supra* note 404, ¶ 763(h)(i).

*Agriculture Machinery*.[501] Brazil used this 1958 case to support its argument that the Agriculture and SCM Agreement obligations are parallel, or apply cumulatively, unless a true conflict exists between them. The early GATT case involved a subsidy to agricultural producers contingent on the purchase of domestic goods, which the Panel found to be inconsistent with the GATT Article III:4 national treatment rule. Surely, Uruguay Round negotiators did not intend to unwind this long-standing rule against discrimination through the Agriculture Agreement.

Second, the Appellate Body itself cited its 1997 Report in the *Bananas* case. In that case, it interpreted Article 21:1 of the Agriculture Agreement to mean GATT and the other accords in Annex 1A to the WTO Agreement apply to agricultural products "except to the extent that the Agreement on Agriculture contains specific provisions dealing specifically with the same matter." Thus, in *Cotton*, the Appellate Body re-framed the issue before it as "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." The Appellate Body stressed that its approach in the two cases was consistent. In both, it refused to read the scope of a text to cover a matter not expressly mentioned in the text, and thus expressed fidelity to the intent of the drafters, who would have put in the missing point if they meant the text to cover it.

Unfortunately, however, in *Cotton*, the Appellate Body did not clean up its hideously awkward phrase from the precedent-setting case, "specific provisions dealing specifically with the same matter." (Judicious use of the word "overlap," or some variant of it, would serve well.) Equally regrettable was the selective memory of the Appellate Body. Had it forgotten it did engage in interstitial lawmaking when interpreting whether GATT Article XIII applied to country-specific tariff rate quota (TRQ) allocations to non-principal supplying countries?[502]

The United States, too, seemed to forget a lesson from the Bananas War. Among the many texts at issue in the *Bananas* case were Articles 4:1 and 4:2 of the Agriculture Agreement. The Appellate Body said they are silent on the allocation of TRQs. Thus, it rejected a defense of the EC, namely, the Agreement shielded EC banana TRQs from scrutiny under GATT Article XIII, because the TRQs were consistent with market access concessions under these Articles. Conceptually, the United States mounted the same defense for Step 2 Payments to users as the EC had for its TRQs—the Agriculture Agreement deals with the matter, so it, and not some other WTO text, governs. The defense has now failed twice. The next time a respondent tries to use the Agreement as a shield, it had better construct that shield with unambiguous text in the Agreement that covers

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501. *See id.* ¶ 528. For a discussion of this case, see generally RAJ BHALA, MODERN GATT LAW: A TREATISE ON THE GENERAL AGREEMENT ON TARIFFS AND TRADE (2005).

502. *See* Raj Bhala, *The Bananas War*, 31 MCGEORGE L. REV. 839, 839-971 (2000).

the same matter, dealt with by the provision in a different accord (such as GATT or the SCM Agreement) that the claimant uses as a sword.

d. The Dissent is Right

As if it were aware of the risk of criticism for being judicially active, in the *Cotton* case the Appellate Body Report offered examples of judicial conservatism. Clinging tightly to its familiar lexicographic sources, the Appellate Body made several rulings in which it refused to stray from the relevant texts. But, addressing whether U.S. export credit guarantees are governed by Article 10:1 of the WTO Agreement on Agriculture (as Brazil argued), or exempt from any disciplines by virtue of Article 10:2 (as the United States urged), the Appellate Body provided grist for a new criticism: its text-bound conservatism can border on mindless.

The two-member majority ruled in favor of Brazil, showing signs of activism, and thus inconsistency with its earlier rulings. The Appellate Body upheld the Panel's rationale that Uruguay Round negotiators would have exempted export credit guarantees from the export subsidy disciplines of Article 10:1 by inserting explicit textual language to that effect in either Article 10:1 or 10:2.[503] This rationale is conservative, insofar as it refuses to stray beyond the four corners of the text. At the same time, the majority exhibited activism. It re-wrote Uruguay Round negotiating history, by asserting into these provisions its preference that the world trading community not be left in a state of unregulated export credit guarantees.

There also is an irony to the rationale. Perhaps the majority thought it was being conservative by refusing to infer a drafting intent it could not find from the text. But, in so doing, the majority was making new law—namely, declaring that export credit guarantees are subject to Article 10:1. Arguably, an authentic conservative position would have been to look at the Agriculture Agreement as a whole, including its drafting history and the context of the Uruguay Round negotiations. The result would have been a less expansive scope for Article 10:1. The Appellate Body suggested it—or, more accurately, the Panel—had looked at the context of the Agreement, especially Article 10, in light of its object and purpose. But, perhaps its short paragraph is more the assertion borne of concealed doubt than analysis springing from judicial wisdom.[504]

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503. *See Cotton* Appellate Body Report, *supra* note 404, ¶¶ 608-609.

504. Paragraph 613 of the *Cotton* Appellate Body Report states:

> 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

Most importantly, the rationale of the Panel as upheld by the two-member Appellate Body majority is also senseless, as the dissent—siding with the United States —explained (in somewhat less mind-numbingly dull terms than the majority used).[505] A fair reading indicates the dissent is correct at law and consistent in philosophy with the earlier rulings in the case it joined.

Essentially, the dissent argues that Article 10:2—the only provision in the Agriculture Agreement that speaks directly to export credit guarantees, export credits, and insurance programs for farm products—contains two undertakings, neither of which is an immediately enforceable limitation on these kinds of programs currently in existence. First, WTO Members are committed to work toward developing international disciplines on these measures. Second, once they have agreed on those disciplines, they will follow them. The first undertaking suggests that no such disciplines yet exist. The second one limits the application of disciplines to the time after they do exist. Further, the absence of any reference in Article 9 to export credit guarantees, export credits, and insurance programs suggested that these measures are not subject to any strictures until such time as disciplines are agreed. If Article 10:2 did not exist, then Article 10:1 would cover the export subsidy portion of an export credit guarantee program. But, it does exist, and thus signals that the negotiators foresee disciplines being established in the future. Therefore, none exist now. Not a model of clarity, the dissent concedes, in that the Uruguay Round negotiators could have expressed their intentions plainly. Maybe it is not the best policy outcome either, but the gap in regulation is not for the Appellate Body to fill.

Lest there be any doubt about the intent of the negotiators, the dissent points to the negotiating history to resolve it. In December 1991, a "Draft Text on Agriculture" was circulated that would have applied to agricultural products the disciplines in the Illustrative List of Export Subsidies annexed to the SCM Agreement. The Draft Text of what then was Article 9:3 of the Agriculture Agreement specifically lists export guarantees: "[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*]."[506] In the next iteration, the Draft Final Act that was circulated, Paragraph 3 of Article 9 is omitted. It is replaced with an "undertak[ing] not to provide export credits, export credit guarantees or insurance programs otherwise

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particular Article 10, which is entitled "Prevention of Circumvention of Export Subsidy Commitments."

*Id.* ¶ 613.

505. *Id.* ¶¶ 631-641.

506. *Id.* ¶ 636 n.947.

than in conformity with internationally agreed disciplines."[507] This undertaking becomes Article 10:2.

There is one other point the dissent probably could not, and should not, have made. Was it wise for the two-member majority to hand the United States another defeat in the *Cotton* case, thus leading to a shut-out for Brazil? The politics of this case are enormously sensitive, in Congress, in the Cotton 4 countries, and in many places in between. To be sure, political factors should not drive judicial outcomes. But, there was no need to humiliate the Americans either, if the shared goal was reasonable reform of trade-distorting cotton subsidies. Might the majority have tempered its holdings with some politically astute mercy?

## B. Export Subsidies and Sugar

### 1. Citation

*European Communities – Export Subsidies on Sugar*, WT/DS265/AB/R, WT/DS266/AB/R, WT/DS283/AB/R (issued April 28, 2005, adopted May 19, 2005) (complaints by Australia, Brazil, and Thailand).

### 2. Facts[508]

It was not the first time that the EC lost a case concerning sugar subsidies provided through the Common Agricultural Policy (CAP). In 1980, the GATT Contracting Parties adopted a Panel Report, *EC – Refunds on Exports of Sugar*, based on a Brazilian complaint lodged in 1978.[509] Australia, Cuba, India, and Peru supported the complaint. Brazil argued successfully under GATT Article XVI:1 that refunds on exports of sugar were a subsidy that caused serious prejudice, in the form of price depression in 1978-79, to Brazil's sugar industry. (Brazil did not prevail on its Article XVI:3 claim that the subsidy led to the EC having more than an equitable share in the world market).

During the last quarter century, the EC has not made changes in its CAP sugar regime that address the fundamental concerns of the likes of Brazil. Hence, once again Brazil, joined by its old sugar ally, Australia, and a new ally, Thailand, brought a case against the EC. The bottom-line result was the same—judgment against the EC, this time both at the Panel and Appellate Body stages. The complaints of Australia, Brazil, and Thailand (the latter again supported by the

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507. *Id.* ¶ 636.

508. *Sugar Export Subsidies* Appellate Body Report, *supra* note 275, ¶¶ 1-12, 230 n.352, 231 n.357, unless otherwise noted.

509. *See* BHALA, *supra* note 501, at ch. 31, §§ I-IV, ch. 39, §§ VIII-X (2005).

Advisory Centre on WTO Law), brought in 2004, effectively were consolidated (though at the EC request, pursuant to DSU Article 9:2, separate but identical Panel Reports were issued). The Appellate Body also received an *amicus curiae* brief from the Association of Central American Sugar Industries (*Azucareros del Istmo Centroamericano*) (AICA), but found it unnecessary to consider the brief.

These Complainants focused on export subsidies for sugar and sugar-containing products provided by Council Regulation (EC) No. 1260/2001 of 19 June 2001 (EC Regulation 1260/2001) and related instruments, collectively referred to as the "EC Sugar Regime." This Regime was in place for MYs 2001-02 through 2005-06, and consisted of the following elements:

- Two categories of quotas for sugar production, one for "A" sugar and one for "B" sugar. The A and B quotas are the maximum quantity of sugar eligible for domestic price support and direct export subsidies. There is no difference in the physical characteristics of A and B sugar.
- A distinction between (1) "A" and "B" sugar and (2) "C" sugar, namely, "A" and "B" sugar are "quota sugar" and "C" sugar is "non-quota sugar." Non-quota sugar must be exported (or carried forward). C sugar has the same physical characteristics as A and B sugar.
- A domestic price support scheme, consisting of –
  - (1) An intervention price for raw sugar.
  - (2) An intervention price for white sugar.
  - (3) A basic price for "beet for quota sugar" production, i.e., for beet produced for the A and B quota called "A beet" and "B beet," respectively. (Sugar comes from one of two sources, cane or beet.) "C beet" is beet used for C sugar production. There is no difference between the physical characteristics of A, B, or C beet.
  - (4) A minimum guaranteed price for A and B beet for quota sugar production, but not for C beet. The minimum prices for A and B beet, respectively, are 46.72 and 32.42 euros per ton. The per ton price at which C beet is sold to producers and exporters of C sugar is 10-20 euros, which (as discussed below) is considerably below the average total cost of production of C beet).
- Import and export licensing requirements.
- Producer levies.
- Preferential import arrangements.
- Direct export subsidies, namely, "export refunds" provided to EC sugar exporters for certain quantities of sugar, other than non-quota (i.e., C) sugar. C sugar must be exported (unless it is

> carried forward), but no refunds are provided to such exports. Export refunds cover the difference between the EC internal market price and the prevailing world market price for sugar.

The Panel rendered two significant conclusions, contrary to the EC position.

The EC set its commitment levels, in terms of budgetary outlay and quantity, for exports of subsidized sugar, in the entry in Section II, Part IV, of its Schedule. Footnote 1 (the Footnote) to that entry states: "Does not [i.e., the EC export subsidy reduction commitments for sugar] include exports of sugar of ACP and Indian origin on which the Community is not making any reduction commitments. The average of export in the period 1986 to 1990 amounted to 1.6 mio t [million tons]." The EC argued this Footnote enlarges its commitment levels. In particular, the Footnote enlarged the commitment from an annual 1,273,000 tons and 499.1 million euros to an additional 1.6 million tons of sugar.

The Panel's first key conclusion was to reject this argument. The Panel held Footnote 1 has no legal effect in relation to the entry in the Schedule.[510] The ordinary meaning of the first sentence of the Footnote, said the Panel, is to convey that the EC is not making a commitment to limit subsidies on exports of sugar of ACP/Indian origin. That is, the first sentence is a unilateral declaration by the EC that it is not subjecting sugar of ACP/Indian origin to export subsidy reduction commitments. The EC reading of this sentence is incongruous with the Agriculture Agreement (especially Articles 3, 8, 9:1, and 9:2(b)(iv)). The sentence does not set out any budgetary outlay limits. Moreover, the EC has not made any commitments on limiting subsidies to ACP/India equivalent sugar. If the first sentence meant what the EC thought, then why did it not contain the language of an export subsidy commitment level, with a budgetary limit and reference to sugar of non-ACP, non-Indian origin?

Put differently, even if the first sentence limited, and thereby enlarged, sugar export subsidies, the higher ceiling would pertain only to sugar from ACP countries or India that the EC re-exports. Contrary to the EC argument, the benefit of an enlarged commitment level would not redound to sugar produced outside of the ACP and India that the EC regards as "equivalent" to the amount it imports from the ACP and India. As for the second sentence of the Footnote, it too, has a plain meaning. It states the average EC sugar exports in the base period. In sum, held the Panel, neither the first nor second sentence suggests a commitment limiting export subsidies that would enlarge the EC's commitment levels in Section II, Part IV of the Schedule.

To what levels did the EC commit? Section II, Part IV of its Schedule indicates the EC agreed to cut sugar export subsidies as follows:

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510. *See Sugar Export Subsidies* Appellate Body Report, *supra* note 275, ¶¶ 4(a), 129(a), 160-164, 346(b).

> ● The "base quantity level," i.e., the average of the quantity of subsidized exports of sugar during the base period, which in 1986-90, is 1,612,000 tons.
> ● The EC agreed to reduce progressively the base quantity level to 1,273,500 tons in the MY 2000-01, and this amount would be the "final quantity commitment level" for sugar.[511]
> ● The "base outlay level," i.e., the average of the budgetary outlay on subsidized exports of sugar during the 1986-90 base period, was 779.9 million euros.
> ● The EC agreed to reduce progressively the base outlay level to 449.1 million euros in the MY 2000-01, and this amount would be the "final budgetary outlay commitment level" for sugar.[512]

The Panel's second key conclusion was to agree that Australia, Brazil, and Thailand provided *prima facie* evidence that the total exports of sugar from the EC in every year since 1995 far exceeded the quantity commitment level.

Specifically, in the MY 2000-01, the EC exported 4,097,000 tons of sugar—an excess of 2,823,500 over the commitment level.[513] Put colloquially, the EC blew its quantity cap, thus violating Articles 3:3 and 8 of the WTO Agreement on Agriculture. Similarly, the Panel accepted *prima facie* evidence from the Complainants that since 1995 the EC provided export subsidies within the meaning of Article 9:1(a) of the Agriculture Agreement on sugar the EC considered to be so-called "ACP/India equivalent sugar."[514] (Article 9 is quoted in full in the discussion of the *Cotton* case, above.) Accordingly, the Panel's final noteworthy conclusion was to agree that the Complainants made a *prima facie* case that the EC had been giving an export subsidy, within the meaning of Article 9:1(c) of the Agreement, to exports of C sugar.[515]

### 3. The Three Major Substantive Issues on Appeal

On appeal, the EC lost on each of the three major substantive issues it raised:[516]

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511. *See id.* ¶¶ 4(c), 157, 159.
512. *See id.* ¶¶ 4(b), 157, 159.
513. *See id.* ¶ 4(d).
514. *See id.* ¶ 4(e).
515. *See id.* ¶ 4(f).
516. In addition to the above-treated matters, the EU raised—and lost—the following issues:

> ● Whether the Panel erred in finding that "payments" (in the form of low-priced sales of C beet to sugar producers) within the meaning of Article 9:1(c) of the Agriculture Agreement fell within its terms of

- Whether the Panel erred in finding that Footnote 1 to Section II, Part IV of the EC Schedule has no legal effect, and does not enlarge the commitment levels that the EC specifies in this Schedule.[517]
- Whether the Panel erred in finding that payments, in the form of low-priced sales of C beet to sugar producers, are "financed by virtue of governmental action" within the meaning of Article 9:1(c) of the Agriculture Agreement.[518]
- Whether the Panel erred in finding that production of C sugar receives a "payment on the export financed by virtue of governmental action" within the meaning of Article 9:1(c) of the Agriculture Agreement, the payment being transfers of financial resources resulting from the operation of the EC Sugar Regime.[519]

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reference. *See Sugar Export Subsidies* Appellate Body Report, *supra* note 275, ¶¶ 129(a), 131-56, 346(a).

- Whether the Panel erred in finding that there is *prima facie* evidence the EC has been providing export subsidies under Article 9:1(c) of the Agriculture Agreement to its exports of C sugar since 1995. *See id.* ¶¶ 4(f), 129(e), 227-283, 287-290, 346(e)-(f).
- Whether the Panel erred in finding that the EC violations of the Agriculture Agreement nullified or impaired the benefits accruing to Australia, Brazil, and Thailand under that Agreement. *See id.* ¶¶ 129(f), 293-300, 346(g).
- Whether the Panel erred in finding that Australia, Brazil, and Thailand acted in good faith under Article 3:10 of the DSU in initiating the case, and the actions or silence of these Complainants do not estop them from alleging EC exports of C sugar are in excess of EC export subsidy reduction commitments. *See id.* ¶¶ 129(g), 301-320, 346(h).

Finally, the Complainants raised and lost two issues on appeal:

- Whether the Panel erred in exercising judicial economy by declining to examine the claims of Australia, Brazil, and Thailand under the Red Light export subsidy provisions of Article 3:1(a) and 3:2 of the Agreement on Subsidies and Countervailing Measures. *See id.* ¶¶ 129(h), 321-341, 346(i).
- Whether certain aspects of the Notice of Appeal filed by the EC satisfied the Working Procedures for Appellate Review (Rule 20(2)(d)). *See id.* ¶¶ 129(i), 342-45, 346(j).

517. *Sugar Export Subsidies* Appellate Body Report, *supra* note 275, ¶¶ 4(a), 129(b), 157-226, 346(b), (f).

518. *See id.* ¶¶ 129(c), 227-283, 287-290, 346(c), (f).

519. *See id.* ¶¶ 129(d), 227-283, 287-290, 346(d), (f).

Each of the issues is discussed in turn below.

4. Holdings and Rationale

a. The Meaning of Footnote 1

The first issue, while idiosyncratic to Footnote 1, is a straightforward matter of how to read the plain meaning of a citation.[520] The EC sought to read far more, and infer far more, from the citation, than any reasonable interpretation would allow. Simply reiterating its arguments from the Panel statement, the EC said Footnote 1 is a distinct component to its export subsidy commitments, supplementing its budgetary and quantity commitment levels for sugar in its Schedule. The first sentence of the Footnote, repeated the EC, says it makes no export subsidy reduction commitments on sugar exports equivalent in volume to its annual imports of sugar from ACP countries and India (i.e., on exports of ACP/India equivalent sugar).

The EC argued the second sentence of the Footnote meant it is "limiting" the volume of ACP/India equivalent sugar it subsidizes to the lower of (1) actual imports from ACP countries and India or (2) 1.6 million tons. Thus, urged the EC, Footnote 1 allows an additional subsidized export amount of up to 1.6 million tons of sugar, and is a separate commitment to "limit" sugar export subsidies to the lower of actual imports of ACP/India sugar or 1.6 million tons.

To juxtapose the interpretation advocated by the EC against the language of the statute is to appreciate how preposterous the EC interpretation is. Australia, Brazil, and Thailand all pounced on this interpretation.[521] It defies the English language, contorting the plain meaning of words beyond recognition for a self-serving purpose. Thus, for example, the words "exports of sugar of ACP and Indian origin" in the first sentence of Footnote 1 does not mean, as the EC would have it, "exports of ACP/Indian equivalent sugar."

Had the EC intended that its commitment levels appropriately covered export refunds not only on the re-export of sugar originally of ACP/Indian origin, but also on an equivalent quantity of non-ACP, non-Indian sugar exports, then the EC ought to have negotiated during the Uruguay Round to insert this into the text of its Schedule and Footnote 1. It did not, and it is not persuasive for the EC to rely on presumed knowledge of other WTO Members based on sketchy negotiating history consisting of letters and memoranda on the applicability of unclear sugar export subsidy reductions.

Similarly, the plain meaning of the second sentence shows no commitment to limit sugar export subsidies. Contrary to the EC view, it is illogical to infer such a commitment from the reference to the "average of export

520. *See id.* ¶¶ 169-226.
521. *See id.* ¶ 172.

in the period 1986 to 1990." True, a base period is the start for any reduction commitment. But, the first sentence states clearly the EC is "not making any reduction commitments," which renders the EC inference all the more illogical.

Also, contrary to the EC view, the practice of providing subsidies to sugar exports equivalent in volume to actual imports from ACP countries and India is not a basis to infer a commitment to limit subsidization in the second sentence. The source of that practice is not clear. The second sentence simply conveys information about a base period quantity. Lest there be doubt, if the second sentence did commit the EC to export subsidies equal in volume to the lower of actual ACP/Indian sugar imports or 1.6 million tons, then why did the EC not notify the WTO Committee on Agriculture of the status of its compliance with this purported commitment?

The Appellate Body could have adequately addressed the EC interpretation by standing on the above rationale, essentially tracking that of the Panel. However, the Appellate Body added three points to further support its holding, which may be closer to *obiter dicta* than rationale. Two of the points are discussed in the Commentary below. The third point concerns GATT-WTO precedents on the importance of a scheduled commitment.

Specifically, the Appellate Body explained why Footnote 1 could not prevail over the Agriculture Agreement, notwithstanding its inconsistency with Articles 3:3 and 9:1 of that Agreement.[522] The EC argued there is no hierarchy between a Schedule of export subsidy commitments made by a WTO Member and the Agreement. Under Article 8 of the Agreement, "[e]ach Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule."

Precedent also defeats the EC argument, and the Appellate Body recited the cases, most notably, the 1989 adopted GATT Panel Report, *United States – Restrictions on Imports of Sugar*. The Appellate Body further cited three of its own Reports: *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R (adopted 25 September 1997), *European Communities – Measures Affecting the Importation of Certain Poultry Products*, WT/DS69/AB/R (adopted 23 July 1998), and *Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R (adopted 23 October 2002).

Put in the language of precedent, the EC made an argument conceptually similar to one the United States had made in the 1989 *Sugar* case. In that case, the United States used GATT Article II:1(b) as a shield against the sword of Article XI:1, saying an exception it had written into its Tariff Schedule to permit sugar quotas rendered these quotas safe from challenge as a prohibited quantitative restriction. In the case at bar, the EC tried to use Footnote 1 as an exception to its export reduction subsidy commitments. Like the GATT Panel, the Appellate Body would not permit one provision of a legal text to undermine a solemn

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522. *See id.* ¶¶ 211-223.

obligation created by another provision, especially where there is no evidence to indicate an exception. In the absence of a specific provision entitling WTO Members to depart from their GATT-WTO obligations, they are not entitled to do so. That was jurisprudence from the 1989 *Sugar* case with respect to GATT, and it continues through the three aforementioned Appellate Body Reports with respect to the WTO accords.

Thus, the Appellate Body rightly reminded the EC of the importance of its Schedule. GATT Article II:7 states a Schedule annexed to GATT (and, by extension, the WTO Agreement) is an integral part of GATT (and the WTO Agreement). Article 3:1 of the Agriculture Agreement says export subsidy commitments in a Schedule are an integral part of GATT-WTO obligations. Footnote 1, as a part of the EC Schedule, is an integral part of these obligations. Most significantly, nothing in Agriculture Agreement entitled a WTO Member to depart in its Schedule from its obligations under the Agreement. Indeed, there is a clear hierarchy between the export subsidy commitments in a Member's Schedule and the Agreement. That hierarchy is established as follows:

- Article 21 of the Agriculture Agreement states in the event of a conflict between the Agreement, on the one hand, and GATT or another Multilateral Trade Agreement in Annex 1A to the WTO Agreement, on the other hand, the Agriculture Agreement prevails.
- Similarly, the General Interpretative Note to Annex 1A to the WTO Agreement states in the event of a conflict between GATT, on the one hand, and a different, specific Annex 1A accord (e.g., the Agriculture Agreement), on the other hand, the specific accord prevails.
- A Schedule of export subsidy commitments, including citations thereto like Footnote 1 in the EC Schedule, is an integral part of GATT by virtue of Article 3:1 of the Agriculture Agreement.
- Therefore, pursuant to Article 21 of the Agriculture Agreement, if there is a conflict between (1) the Footnote (a part of GATT) and (2) the specific accord (namely, the Agriculture Agreement), the latter text prevails.

All the Appellate Body had left to do was explain for the record, that the Panel over-stated matters when the Panel said Footnote 1 has no legal effect.[523] The Footnote does have legal effect, but in accordance with the above hierarchy.

523. *See Sugar Export Subsidies* Appellate Body Report, *supra* note 275, ¶ 225.

b. Governmental Action and Payments under Article 9:1(c) of the Agriculture Agreement[524]

The Panel observed that the EC Sugar Regime contained two kinds of suspect payments:[525]

> ● Below-cost sales of C beet to C sugar producers/exporters:
> Producers of C sugar receive a payment on the export of C sugar. The payment takes the form of sales of C beet (used to produce C sugar) by beet growers to sugar producers at prices below the average total cost of production of C beet. In turn, the below-cost sales prices are made possible by governmental action.
> ● Cross-subsidization:
> Financial resources are transferred to producers/exporters of C sugar upon export of that sugar. The resource transfer is cross-subsidization, which occurs because of the way the EC Sugar Regime operates. Essentially, profits made on sales of A and B sugar are used to cover the fixed costs of producing and exporting C sugar. Governmental action makes this cross-subsidization possible.

These payments are, the Panel held, "payments on the export . . . financed by virtue of governmental action," as Article 9:1(c) of the Agriculture Agreement states. Consequently, under Article 9:1, the two payments are export subsidies subject to reduction commitments.

The Panel reasoned that C beet sales are a subsidy because they are below beet production costs. A large percentage of farmers of C beet are likely to finance their sales of C beet below the cost of production by simultaneously selling, in the domestic market, high-priced A and B beet. They are an export subsidy because they are provided on the export of C sugar. The Panel said the below-cost sales fell within Article 9:1(c) because there was a "demonstrable

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524. *See id.* ¶¶ 227-250.

525. The Panel also observed that payments took the form of:

> ● Exports of C sugar below the total cost of production
> ● High prices for sugar paid by consumers.

Panel Report, *European Communities – Export Subsidies on Sugar*, WT/DS283/R (Oct. 15, 2004) [hereinafter *Sugar Export Subsidies* Panel Report]. However, the Panel did not consider whether these kinds of payments were export subsidies.

link" and a "clear nexus" between the financing of the payments and governmental action.[526]

Indeed, the EC controls nearly every aspect of the supply and management of domestic beet and sugar. For example, the EC fixes the price and supply of A and B beet to ensure that beet growers have an adequate, stable income. The EC mandates the over-quota beet, i.e., C beet, can be used only to produce C sugar, which itself is over-quota and must be exported. If a producer diverts C sugar into the domestic market, then the EC imposes financial penalties. The behavior of the EC is nothing short of "controlling governmental action" that is "indispensable" to transferring money from consumers and taxpayers to sugar producers and also, using the producers as a conduit, to A and B beet growers.[527]

Concomitant with its Article 9:1(c) conclusion, the Panel rendered a verdict on Article 10:3 of the Agriculture Agreement. The Panel found that the EC failed to prove it complied with Article 10:3 of the Agreement, which states: "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." The EC failed to prove it had not (in every year since 1995) subsidized C sugar exports beyond its commitment levels. The EC did not appeal the Panel's holding or rationale that below-cost C beet sales are an export subsidy. Rather, it appealed the conclusion that the sales were payments financed by virtue of governmental action under Article 9:1(c).

The Appellate Body upheld the Panel's export subsidy conclusion by citing and emphasizing precedents from earlier Appellate Body decisions, namely, *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), and two compliance reports in that case, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Recourse to Article 21:5 of the DSU by New Zealand and the United States* (WT/DS103/AB/RW, WT/DS113/AB/RW, adopted 18 December 2001) and *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Second Recourse to Article 21:5 of the DSU by New Zealand and the United States* (WT/DS103/AB/RW2, WT/DS113/AB/RW2, adopted 17 January 2003).[528] Taken together, these Reports established:

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526. *See Sugar Export Subsidies* Appellate Body Report, *supra* note 275, ¶ 230 (quoting *Sugar Export Subsidies* Panel Report, *supra* note 525, at ¶ 7.291).

527. *Id.* ¶ 231 (quoting *Sugar Export Subsidies* Panel Report, *supra* note 525, ¶ 7.291).

528. *See id.* ¶¶ 234-237 nn.361-72.

The EC offered the nearly jocose response that its governmental action under the Sugar Regime was "less pervasive"—i.e., not as bad—than official Canadian involvement in the dairy market. The Appellate Body rightly gave the point short shrift, saying the issue is not comparative to the severity of government intervention. *See id.* ¶ 244.

- Article 9:1(c), which embodies one of the itemized examples of export subsidies subject to reduction commitments, contains three criteria to qualify: (1) there must be a "payment," (2) the payment must be "on the export of an agricultural product," and (3) the payment must be "financed by virtue of governmental action."
- The third criterion contains three elements, namely: (1) there must be "financing," (2) the financing must be "by virtue of" governmental action, and (3) there must be "governmental action."
- As to the first element, it does not matter whether the government itself makes payments or whether it provides resources for producers to make payments. Rather, the payments could be both funded and made by private parties.[529]
- The second element essentially involves causation. There must be a "nexus" or "demonstrable link" between governmental action and financing of payments.[530] Not every governmental action has the requisite nexus. For example, if the government creates a regulatory framework merely enabling a third person to finance and make payments, then the link between governmental action and payments is too tenuous to say the payments are financed "by virtue of" official action.[531] How tight must the nexus be? The answer is to analyze, case-by-case, the relationship between the government and the process by which a private party funds or makes payments to see whether the government "play[s] a sufficiently important part" in that process.[532]
- "Governmental action" involves the regulation, control, or supervision of individuals, or some form of restraint of their conduct, but need not take a particular form, such as a mandate or direction.[533]

The Appellate Body simply applied the above precedents to the facts. That is, the Appellate Body repeated the facts on which the Panel relied. In a rather jumbled paragraph, the Appellate Body said the EC provides payments on

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529. *See id.* ¶ 236.

530 *Id.* ¶ 230 (quoting the Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Recourse to Article 21:5 of the DSU by New Zealand and the United States*, WT/DS103/AB/RW, WT/DS113/AB/RW (Dec. 3, 2001)).

531. *See Sugar Export Subsidies* Appellate Body Report, *supra* note 275, ¶ 237.

532. *Id.*

533. *See id.* ¶ 235.

the exports of an agricultural product, sugar, financed by virtue of governmental action, because:[534]

> ● The EC controls virtually every aspect of the supply and management of domestic beet and sugar. For instance, the EC imposes a financial penalty on a sugar producer for diverting C sugar from exportation into the domestic market. As another example, the EC's Sugar Management Committee protects domestic sugar by managing supply. The EC also regulates the prices of A and B beet, setting them at artificially high levels.
> ● Another illustration of government action is that the EC establishes a framework for contractual relationships between beet growers and beet sugar producers, who purchase beet from the growers, so as to ensure stable, adequate income for the growers. That framework includes C beet sales above the marginal cost of production, but below the average total cost of production. (The price of C beet is about [sixty] percent of the C sugar world market price, which is far below the average total production cost.) C beet growers, then, cover their fixed costs by sales of A and B beet.
> ● Invariably, A, B, and C beet are produced together in a single line of production. C beet is an important input into C sugar. C sugar represents [eleven to twenty-one] percent of overall EC production of A and B sugar. C beet represents the same proportion of A and B beet production.
> ● A large percentage of beet growers likely finance their sales of C beet, which they make at below production costs, from highly remunerative sales of A and B beet.
> ● Sugar producers have an incentive to make C sugar so they can maintain their share of A and B quotas. (By producing an overage—C sugar—they are sure to keep an A and B quota.)
> ● Beet growers have an incentive to supply as much quantity of C beet as C sugar producers request. By doing so, the growers know they will receive high prices for A and B beet, and an allocated amount for C beet. Indeed, the continued production of large volumes of over-quota beet (i.e., C beet) at prices below cost of production could not occur but for governmental action, namely, the creation of quotas and regulation of prices. It appears C beet, representing between [five and fifteen] percent of the total EC quota production, is grown intentionally by beet growers.

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534. *See id.* ¶ 238. *See also id.* ¶¶ 247-248 nn.399-402 (elaborating on some of the facts).

The Appellate Body would have done better to seize the opportunity for straight talk as to why the EC Sugar Regime was something of an export subsidy scam.

That "here-is-what-is-really-going-on" explanation would be as follows. The EC Sugar Regime requires C sugar be exported. The price of C beet is approximately sixty percent of the world market price for C sugar. The only way C beet growers can afford to sell C beet to C sugar producers at below the average total cost of production for C beet is for the EC to regulate the price of A and B beet. That regulation takes the form of artificially high A and B beet prices. With A, B, and C beet grown in the same line of production, growers make big profits from government-regulated high A and B beet sale prices and use those profits to offset losses from C beet sales. Conversely, C sugar producers save money on purchases of below-cost C beet, which finances their above-market A and B purchases. The essence of the export subsidy is the below-cost input, C beet. The EC trisects the beet and sugar market, keeping input prices artificially high in two sections (A and B beet) to fund low prices in the third sector (C beet). By requiring C sugar to be exported, the EC assures this sugar, which by definition contains the subsidized input, C beet, is dumped (used loosely) overseas.

Who loses from the scam, which has led to the sale of C sugar on the world market at prices well below the average total cost of production in every year from MY 1992-93 to 2002-03? One group is all beet and sugar producers outside of the European Union and ACP countries. Another group is EC consumers who pay above-market prices for sugar.

c. Payments, Cross-Subsidization, and Export Subsidies under Article 9:1(c) of the Agriculture Agreement[535]

The Panel held transfers of financial resources from high revenues derived from sales of A and B quota sugar cross-subsidize export production of C sugar. These transfers, concluded the Panel, constitute an export subsidy under Article 9:1(c) of the WTO Agreement on Agriculture. The Appellate Body had no difficulty upholding these findings.

On appeal, the EC offered two arguments. Recounting them reveals their weaknesses. First, cross-subsidization is not a payment because it is not a "transfer of financial resources" to sugar producers. Rather, the alleged cross-subsidization really is an internal allocation of resources by each sugar producer that provides no benefit to the producer. Second, the alleged payment does not occur "on the export" of C sugar, because C sugar producers are not required to make or export production. Said the EC, if the Appellate Body upholds the Panel's interpretation of Article 9:1(c), then it will turn this provision into a prohibition on low-priced exports and a blunt anti-dumping instrument.

535. *See id.* ¶¶ 251-283, unless otherwise noted.

The first argument was a laughable effort to put a euphemism on reality. From the second argument, a cynic might infer some EC lawyers needed an ESL refresher course. The Appellate Body did not rule against the EC in such a sarcastic manner. Rather, reciting precedent, it firmly rejected both arguments. "Payment" is a broad term:

> 259. The Appellate Body interpreted Article 9.1(c) of the Agreement on Agriculture in the appeal in *Canada – Dairy*, as well as in the compliance proceedings in that dispute, *Canada – Dairy (Article 21.5 – New Zealand and US)* and *Canada – Dairy (Article 21.5 – New Zealand and US II)*. In those disputes, the Appellate Body held that the word "payment" in Article 9.1(c) denotes "a transfer of economic resources" and that the ordinary meaning of the word "payment" "encompasses 'payments' made in forms other than money." The Appellate Body also found that Article 9.1(c) of the Agreement on Agriculture describes an "unusual form of subsidy," in that "payments" can be made by private parties and need not be made by a government. The Appellate Body has also held that the notion of payments covers "a diverse range of practices involving monetary transfers, or transfers-in-kind;" the "payments" may take place in "many different factual and regulatory settings;" it is necessary to consider the "particular features" of the alleged "payments;" and the standard for determining the existence of "payments" under Article 9.1(c) must be identified after careful scrutiny of the factual and regulatory settings of the measure.
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> 260. In addition, in *Canada – Dairy (Article 21.5 – New Zealand and US)* and *Canada – Dairy (Article 21.5 – New Zealand and US II)*, the Appellate Body held that, in the circumstances of those disputes, the determination of whether payments were made depended on a comparison between the price of a particular product—commercial export milk (CEM) in those cases—and an "objective standard or benchmark which reflects the *proper value of [that product] to [its] provider*." In those disputes, the Appellate Body found that the standard for determining the proper value of CEM was the average total cost of production, as this standard represented the economic resources the producer invested in the milk that was an input to the production of dairy products. If CEM was sold at less than its proper value—namely, its average total cost of production—"payments" were made, because there was a transfer of the

> portion of economic resources that was not reflected in the selling price of CEM.[536]

The Appellate Body pointed out that the EC does not challenge use of average total cost of production as the benchmark to ascertain the existence of a "payment."

Critically, Article 9:1(c) does not limit the term "payment" by referring to the entity making, or receiving, the payment.[537] The EC's approach is, therefore

> 265. . . . too formalistic. To illustrate, one could envisage a scenario under which the producers of C sugar are legally distinct from the producers of A and B sugar. In this situation, the European Communities' approach could recognize that a "payment" under Article 9.1(c) could exist because there would be a transfer of economic resources between different parties. If, however, these same producers of A, B, and C sugar were integrated producers and organized as single legal entities, a payment under Article 9.1(c) would not exist, because the transfer would be merely "internal." We do not believe that the applicability of Article 9.1(c) should depend on how an economic entity is legally organized.
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> 266. Accordingly, we do not share the European Communities' objections to the Panel's findings on "cross-subsidization" in the case before us. In this respect, we are also mindful of the fact that, in the ordinary course of business, an economic operator makes a decision to produce and sell a product expecting to recover the total cost of production and to make profits. Clearly, sales below total cost of production cannot be sustained in the long term, unless they are financed from some other sources. This is especially true when the volume of the loss-making sales is substantial. It may be noted that between 1997 and 2002, C sugar exports varied between 1.3 and 3.3 million tonnes, with the sales price not "even remotely" covering the average total cost of production of sugar.

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536. Citations (all to the Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Recourse to Article 21:5 of the DSU by New Zealand and the United States*, WT/DS103/AB/RW, WT/DS113/AB/RW (Dec. 3, 2001)) are omitted.

537. *See Sugar Export Subsidies* Appellate Body Report, *supra* note 275, ¶ 262.

The "bottom line" is that the fixed costs of producing A, B, and C sugar are largely paid for by profits from sales of A and B sugar, and the EC Sugar Regime creates an advantage by allowing sugar producers to make and export C sugar at below production costs. That is cross-subsidization, which is a "payment" in the form of a transfer of financial resources. Indubitably, this payment provides a "benefit." The question of "benefit" requires no independent inquiry. A measure under Article 9:1 of the Agriculture Agreement is deemed to be an export subsidy under Article 1(e) of that Agreement.

As for the second argument the EC raised on appeal, the Appellate Body simply looked back to the EC Regulation. Once C sugar is produced, it must be exported. True, C sugar may be carried forward to the next MY, up to an amount equivalent to twenty percent of the A sugar quota. In the subsequent MY, it is sold in the EC market, and sugar producers must pay beet growers the guaranteed price that applies to quota beet, not C beet. But, the possibility to store some C sugar for a year does not change the fact that the cross-subsidization payment is made "on the export" of C sugar.

That is because C sugar carried forward essentially gets re-classified as A sugar.[538] Sugar producers pay A beet prices for the input into the sugar they carry forward and are paid the price of A sugar for it. In other words, the EC argument asks to have it both ways: (1) C sugar that is carried forward is re-classified as A sugar, and (2) C sugar that is carried forward is still C sugar and sold on the domestic market. If the sugar is re-classified to A, then it is logically inconsistent to cite this A sugar as an instance of subsidized C sugar that is not exported.

### 5. Commentary

#### a. Redundancy

Redundancy bedevils the Appellate Body Report in the *Sugar* case. The Presiding Member of the Appellate Body was A.V. Ganesan of India. Precisely who was responsible for drafting the report—Ganesan or one of the other members, Merit Janow (United States) or Yasuhei Taniguchi (Japan)—is not a public matter. What is publicly manifest is that the Report illustrates a trait, mentioned privately, sometimes politely, sometimes jokingly, and sometimes angrily, which plagues occasional Indian behavior in international arenas (and in some family matters, too!): endless repetition. The GATT Panel Report spares the reader of this annoyance.

Why, for example, does the Appellate Body quote the text of Article 9:1(c) of the Agreement on Agriculture in Paragraph 233, and then again eight pages later at Paragraph 255? As another instance, the summary in footnote 3 to paragraph 2 re-appears (nearly *verbatim*) as footnote 223 to paragraph 129(a), as

538. *See id.* ¶¶ 277-278.

well as in the first two entries of the Table of Abbreviations at the front of the Report. Thrice informed, the reader is left with the impression that two Appellate Body members e-mail their respective contributions to the third member responsible for assembling the Report, but that no one on the Appellate Body, or in the Appellate Body division of the WTO, takes charge of careful editing—perhaps because, with the demands of translation, there is no time.[539]

Pages 6-44, i.e., paragraphs 13-128, are yet another exhibit of what is needless in the *Sugar* Appellate Body Report. They contain a regurgitation of third party arguments. These arguments might have been better summarized and woven into the rationale of the opinion, or discussed as *obiter dicta*, as and when useful. If a full treatment of them is necessary to demonstrate to the third parties that they have been heard, then why not dump their points into an Annex, rather than over-state their importance by putting them in the heart of the Report and burdening the reader to get past them?

#### b. The Indefensibility of Footnote 1

The Appellate Body offered two points, which seem *dicta*, as to why the EC's own interpretation of Footnote 1, if true, would put the EC in an indefensible position. First, even if Footnote 1 contained the commitment claimed by the EC—to "limit" export subsidies on ACP/India equivalent sugar—then that Footnote would violate Article 3:3 of the Agriculture Agreement. This provision proscribes export subsidies (as listed in Article 9:1) in excess of budgetary outlay and quantity commitment levels a Member specifies in its Schedule. Footnote 1 contains no mention of budgetary outlays. The EC asserts that Article 3:3 does not require a WTO Member to state its export subsidy commitments in terms of both budgetary outlay and quantity commitments. Yet, Article 3:3 states:

> Subject to the provisions of paragraphs 2(b) and 4 of Article 9, a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule.

Here again, the EC's interpretation defies the English language, disrespecting the simplest of its technical rules. Article 3:3 speaks of "budgetary

539. The Appellate Body appeared to allude to this problem in noting that it could not meet the normal ninety day time limit, established by DSU Article 17:5, for circulating its Report. *See Sugar Export Subsidies* Appellate Body Report, *supra* note 275, ¶ 7.

outlay *and* quantity commitment levels," indicating an export subsidy commitment, to be valid, must be specified both ways. The EC read the conjunctive "and" to mean the disjunctive "or," thereby separating the criteria to its own advantage. If the drafters had meant "or," then they would have used the disjunctive "or." Indeed, so obvious is this point, it should never have risen to the Appellate Body, much less occupy five pages (paragraphs 189-200) of the final Report. It ought to have been resolved in a five-minute conversation during the consultation phase of dispute settlement.

Second, opined the Appellate Body, assuming *arguendo* Footnote 1 means what the EC says, then it violates Article 9:1 of the Agriculture Agreement.[540] Article 9:1 says subsidies listed in that Article "are subject to reduction commitments under this *Agreement*." The EC's export subsidies to ACP/India equivalent sugar come within Article 9:1(a), and thus are subject to reduction commitments. Article 9:2(b)(iv) prescribes the relevant commitments:

> [T]he Member's budgetary outlays for export subsidies and the quantities benefiting from such subsidies, at the conclusion of the implementation period, are no greater than [sixty-four] per cent and [seventy-nine] per cent of the 1986-1990 base period levels, respectively. For developing country Members these percentages shall be [seventy-six] and [eighty-six] per cent, respectively.

In other words, the EC should have cut its sugar export subsidies to levels equal or below sixty-four and seventy-nine percent (for budgetary outlay and quantity, respectively) of the base period. Yet, said the Appellate Body, there is no evidence to indicate the EC has reached these levels (taking A, B, and ACP/India equivalent sugar together).

#### c. Private Counsel

An interesting aspect of the *Sugar* case, to which the Appellate Body devotes one paragraph, concerns the role of private counsel.[541] Mauritius told the Appellate Body that it and the other members of the African, Caribbean, and Pacific (ACP) community sought to retain the services of a private lawyer, who had also been hired by two associations for European sugar and beet producers. The retention would cover the oral hearing before the Appellate Body, and obviously would help the ACP cut its legal costs by using a counsel representing another body with the same interests as the ACP.

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540. *See id.*, ¶¶ 201-210.
541. *See id.* ¶ 11.

Australia objected on two grounds. First, the counsel was not a government official. His (or her) appearance would undermine the rule that WTO adjudication is restricted to sovereign governments. Second, the counsel was also engaged in representing two industry associations. There could be an actual or perceived conflict of interest. Was the counsel acting for the WTO Members in the ACP collectively, including some Members that were not third parties to the dispute? Or, was the counsel representing the private clients? Mauritius replied that the attorney was representing solely the WTO Members that were both in the ACP and third party participants.

As is widely understood, the role of private counsel in WTO adjudication is a controversial subject. One aspect of the controversy is the difficulty many poor countries have in participating in DSU matters because of the double curse of limited legal capacity and the high cost of the proceedings. Whether private counsel is a partial remedy is unclear. The Appellate Body appeared to be correct in not making a large issue out of it. The controversy is one for legislative, if not political, resolution, i.e., by the WTO General Council or during a Ministerial Conference.

## IV. SERVICES

### A. Public Morality and On-Line Gambling

#### 1. Citation

*United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/AB/R (issued April 7, 2005, adopted April 20, 2005) (complaint by Antigua and Barbuda).

#### 2. Facts[542]

As a historical fact, the 1997 Appellate Body Report in the Bananas War (*European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R (adopted 25 September 1997)) is the first extended adjudicatory treatment of claims brought under the General Agreement on Trade in Services (GATS). In all probability, however, its Report in *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*—colloquially known as *Antigua Gambling*—will be remembered as the "first real *GATS* case." Maybe that is because in *EC – Bananas*, the War essentially was

542. *See* Appellate Body Report, *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/AB/R, ¶¶ 1-8 (Apr. 7, 2005) [hereinafter *Antigua Gambling* Appellate Body Report].

over with the U.S. victory under GATT Article XIII, but in *Antigua Gambling*, the whole case turned on GATS provisions.

In a WTO variant of the comedy movie "The Mouse that Roared," tiny Antigua-Barbuda, a Caribbean island nation, had the audacity to challenge the mighty United States on federal and state laws that, said the Complainant, made it illegal for suppliers outside America to supply gambling and betting services to consumers within U.S. territory. The population of Antigua is 80,000 (the U.S. population is nearing 300 million). With an economy that is 0.007 percent of the American economy, Antigua is one of the smallest WTO Members.[543]

What country supplied remote gambling services? The answer is none other than the Complainant—the mouse. Antigua hosts on-line gambling facilities—apparently to enough success so as to attract the attention of domestic competitors and substitutes, as well as law enforcement authorities. Never mind the consistent American policy advice to small countries, and for that matter, to Arab oil exporters, to diversify their economies. Some kinds of diversification require a WTO challenge, especially if the diversification is a bit too successful or intrudes on a sector deemed sensitive economically or, as in this case, morally. Antigua posited, contrary to the US obligations under GATS, the United States had "total prohibition" on the cross-border supply of gambling services from Antigua.

For Antigua, the effects of this prohibition were hardly funny. Because of the U.S. restrictions on cross-border internet gambling, three-quarters of Antigua's 119 internet gambling enterprises had closed, with losses amounting to \$90 million.[544] The total prohibition, said Antigua, occurred because of the combined effect of restrictions in the following three Federal and eight State laws:

a. Federal Laws:

● The Wire Act (18 U.S.C. Section 1084), which prohibits a gambling business from knowingly receiving or sending certain types of bets or information that assist in placing a bet over interstate and international wires.[545]

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543. *See* Alan Beattie, *Antigua Accuses U.S. Over WTO Ruling on Gambling*, FIN. TIMES, Feb. 20, 2006, at 4.

544. *See* Daniel Pruzin, *Antigua Preparing to Impose WTO Sanctions Against U.S. in Internet Gambling Dispute*, 23 INT'L TRADE REP. (BNA) 281 (Feb. 23, 2006) [hereinafter Pruzin, *Gambling Dispute*].

545. The Wire Act states:

> Whoever being engaged in the business of betting or wagering knowingly uses a wire communication facility for the transmission in interstate or foreign commerce of bets or wagers or information assisting in the placing of bets or wagers on any sporting event or

● The Travel Act (18 U.S.C. Section 1952), which establishes criminal penalties for utilizing interstate or foreign commerce with the intent to distribute the proceeds of any unlawful activity, including gambling considered unlawful in the U.S.[546]
● The Illegal Gambling Business Act (IGBA, 18 U.S.C. Section 1955), which makes it a federal crime to operate a gambling business that violates the law of the state in which the gambling takes place (subject to fulfillment of certain other criteria, such as involvement of at least five people and an operation during more than [thirty] days).[547]

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> contest, or for the transmission of a wire communication which entitles the recipient to receive money or credit as a result of bets or wagers, or for information assisting in the placing of bets or wagers shall be fined under this title or imprisoned not more than two years, or both.

18 U.S.C. § 1084 (2005).

546. The Travel Act states:

> (a) Whoever travels in interstate or foreign commerce or uses the mail or any facility in interstate or foreign commerce, with intent to –
> (1) distribute the proceeds of any unlawful activity; or
> (2) commit any crime of violence to further any unlawful activity; or
> (3) otherwise promote, manage, establish, carry on, or facilitate the promotion, management, establishment, or carrying on, of any unlawful activity, and thereafter performs or attempts to perform –
> (A) an act described in paragraph (1) or (3) shall be fined under this title, imprisoned not more than [five] years, or both; or
> (B) an act described in paragraph (2) shall be fined under this title, imprisoned for not more than [twenty] years, or both, and if death results shall be imprisoned for any term of years or for life.
> (b) As used in this section (i) "unlawful activity" means (1) any business enterprise involving gambling . . . in violation of the laws of the State in which they are committed or of the United States.

18 U.S.C. § 1952 (2002).

547. The IGBA states:

> (a) Whoever conducts, finances, manages, supervises, directs or owns all or part of an illegal gambling business shall be fined under this title or imprisoned not more than five years, or both.
> (b) As used in this section –

b. State Laws:

- Colorado
(Colorado Revised Statutes Section 18-10-103)
- Louisiana
(Louisiana Revised Statutes (Annotated) Section 14:90.3)
- Massachusetts
(Annotated Laws of Massachusetts Chapter 271, Section 17A)
- Minnesota
(Minnesota Statutes (Annotated) Section 609.755(1) and Section 609.75, Subdivisions 2-3)
- New Jersey
(New Jersey Constitution Article 4 Section VII, Paragraph 2, and New Jersey Code Section 2A:40-1)
- New York
(New York Constitution Article I, Section 9 and New York General Obligations Law Section 5-401)
- South Dakota
(South Dakota Codified Laws Sections 22-25A-1 through 22-25A-15)
- Utah
(Utah Code (Annotated), Section 76-10-1102)

Antigua argued that the American GATS Schedule included specific commitments on gambling services. In particular, the United States inscribed "None" in the relevant columns of its Services Schedule, which (as is the standard understanding of this term) means the United States has no restrictions, i.e., it

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> (1) 'illegal gambling business' means a gambling business which –
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> > (i) is a violation of the law of a State or political subdivision in which it is conducted;
> > (ii) involves five or more persons who conduct, finance, manage, supervise, direct, or own all or part of such business; and
> > (iii) has been or remains in substantially continuous operation for a period in excess of thirty days or has a gross revenue of $2,000 in any single day.
>
> (2) 'gambling' includes but is not limited to pool-selling, bookmaking, maintaining slot machines, roulette wheels or dice tables, and conducting lotteries, policy, bolita or numbers games, or selling chances therein.

18 U.S.C. § 1955 (1994).

accords full market access and national treatment. Because the United States maintained the array of Federal and State laws, it violated its GATS Schedule, and also Articles VI, XI, XVI, and XVII of GATS.

c. Panel Holdings and Major Substantive Issues on Appeal:[548]

Antigua lost its claim under GATS Article VI:1 (which concerns the obligation to administer domestic regulations in a "reasonable, objective, and impartial manner") and under Article VI:3 (which concerns notice to applicants seeking to supply a service where authorization is needed of decisions about their application). Neither of these provisions was at issue on appeal. Similarly, neither Article XI (which concerns payments and transfers) nor Article XVII (concerning national treatment) was an appellate matter. Thus, the focus of the appeal was on GATS Article XVI and the American defense under Article XIV.

The United States successfully persuaded both the Panel and Appellate Body that a "total prohibition" on cross-border supply of gambling services is not a "measure." Rather than lumping all relevant Federal and State laws together, considering their overall cumulative effect, and calling that effect a "total prohibition," it is necessary to challenge each "measure," that is, each Federal and State law and regulation. True, the U.S. Ambassador at a DSB meeting had

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548. *See Antigua Gambling* Appellate Body Report, *supra* note 542, ¶¶ 1-8, 114. In addition to the issues discussed above, the Appellate Body also considered the following matters:

- Whether the Panel, in examining the consistency of U.S. Federal and State laws with GATS Article XIV(a), violated DSU Article 11. *See id.* ¶¶ 114(A)(iii), 328-334, 373(D)(iii)(d). The Appellate Body held that the Panel did, consistently with Article 11, "make an objective assessment of the facts of the case." *Id.*
- Whether the Panel, in considering the U.S. defense under GATS Article XIV, failed to satisfy its obligations under DSU Article 11. *See id.* ¶¶ 114(D)(i), 268-276, 373(D)(i). The Appellate Body scolded (gently) the United States for not raising the Article XIV defense earlier in the proceedings, but held that the Panel acted properly in considering the merits of this defense. *Id.*
- Whether the Panel improperly allocated the burden of proof under GATS Article XIV. *See id.* ¶¶ 114(D)(ii), 277-290, 373(D)(ii). The Appellate Body concluded that the Panel did not improperly assume either the burden of establishing the Article XIV(a) defense on behalf of the United States, or the burden of rebutting it on behalf of Antigua. The Appellate Body said it need not rule on Antigua's appeal of the Panel's analysis of the burden of proof under Article XIV(c). *Antigua Gambling* Appellate Body Report, *supra* note 542, ¶¶ 114(D)(ii), 277-290, 373(D)(ii).

acknowledged the existence of a "total prohibition." Still, the Panel ruled Antigua could not rely on an alleged "total prohibition" as an autonomous "measure" that can be challenged in itself. The United States was correct in contending that the "total prohibition" is not a measure *per se* for purposes of WTO dispute settlement. Three justifications supported the Panel's ruling:

> ● A "total prohibition" is not an "instrument that contains rules or norms," a criterion the Appellate Body laid out in *United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan*, WT/DS244/AB/R (adopted 9 January 2004).
> ● To speak of a "total prohibition" does not precisely identify the relevant laws giving rise to the prohibition.
> ● A respondent, here the United States, would not know how to implement an adverse ruling calling for the "total prohibition" to be brought into compliance, especially where a puzzle of laws creates the prohibition, simply because it would not know the source of the prohibition. Indeed, without knowing the precise source of the prohibition, a respondent would not know how to adequately prepare its defense.

The Appellate Body agreed with the Panel, holding that: "[w]ithout demonstrating the source of the prohibition, a complaining party may not challenge a "total prohibition" as a "measure," *per se*, in dispute settlement proceedings under the *GATS*."[549]

Also citing *U.S. – Corrosion-Resistant Steel*, the Appellate Body pointed out that there are two elements to a "measure." First, there must be a nexus between the measure, which may be an act or omission, and the responding Member, i.e., the measure must be attributable to the Member. Second, the measure must be the source of the alleged impairment, and conversely the impairment must be the effect of the existence or operation of the measure. Antigua failed to identify the source of the prohibition, instead complaining about the collective effect of the operation of several Federal and State laws that impair its GATS benefits.

From a jurisprudential perspective, probably the most important aspect of this ruling is the methodology of the Appellate Body. Evidently, Article I:1 of GATS makes use of the same term as considered in *U.S. – Corrosion-Resistant Steel*. This provision states that the scope of application of GATS is "measured by Members affecting trade in services." The Appellate Body implied that the jurisprudence on the term from GATT and other goods-trade agreements under the WTO is imported into GATS by virtue of Article I:1. Its other choice was to rely solely on the text of Article I:1, ignore the jurisprudence from the world of

549. *Id.* ¶ 126.

goods, and develop a *de novo* interpretation for the world of services. To make that choice would be to create a risk of developing separate meanings for the same word, "measure." It would be a defensible choice, but only if buttressed by clear reasons why the different contexts justify separate meanings. Interestingly, the Appellate Body admitted it left open one question for a future case—whether a "practice" may be challenged, as such, as a "measure" in WTO dispute settlement.[550]

From a practical perspective, the most salient aspect of the ruling by the Panel concerning Antigua's "total prohibition" claim was the victory it then handed Antigua. The Panel might have doomed Antigua's chances through this ruling, essentially dismissing the case because Antigua failed to state a proper claim. Instead, the Panel held Antigua had sufficiently identified the above-listed Federal and State laws so as to warrant substantive examination by the Panel.

Consequently, the United States had to defend its prohibitions—not in a holistic way, but measure by measure. Afterward, the Panel rendered three major findings in favor of Antigua. First, the United States had made specific commitments on gambling services. It set out these commitments in Sub-Sector 10.D of its GATS Schedule.

Second, the United States violated its market access obligations in GATS Article XVI:1-2 because it failed to accord services and service suppliers from Antigua treatment it pledged in its Schedule. Article XVI, entitled "Market Access," states:

> 1. With respect to market access through the modes of supply identified in Article I, each Member shall accord services and service suppliers of any other Member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule.
>
>> [The Footnote at the end of Paragraph 1 states:
>> If a Member undertakes a market-access commitment in relation to the supply of a service through the mode of supply referred to in sub-paragraph 2(a) of Article I and if the cross-border movement of capital is an essential part of the service itself, that Member is thereby committed to allow such movement of capital. If a Member undertakes a market-access commitment in relation to the supply of a service through the mode of supply referred to in sub-paragraph 2(c) of Article I, it is thereby committed to allow related transfers of capital into its territory.]

550. *See Id.* ¶ 132.

> 2. In sectors where market-access commitments are undertaken, the measures which a Member shall not maintain or adopt either on the basis of a regional subdivision or on the basis of its entire territory, unless otherwise specified in its Schedule, are defined as:
>
> > (a) limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test;
> > (b) limitations on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test;
> > (c) limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test;
> >
> > > [The footnote at the end of Sub-Paragraph (c) states: Sub-paragraph 2(c) does not cover measures of a Member which limit inputs for the supply of services.]
> >
> > (d) limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test;
> > (e) measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and
> > (f) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.

Article XVI:1 is an analog to Article II:1 of GATT, albeit roughly, because each commands WTO Members to "keep the promises they make in their Schedules." In the *Gambling* case, the violation arose from all three Federal statutes, plus four State laws—Louisiana, Massachusetts, South Dakota, and Utah. The Panel absolved Colorado, Minnesota, New Jersey, and New York of alleged interference with America's GATS market access commitments under Article XVI. The absolution came under Article XVI:2(a) and (c), because the statutes of the latter four states impose criminal liability on consumers (not suppliers) of cross-border gambling services.

In decisions about GATS Article XVI, the Panel made two key, specific findings. First, it said a prohibition on the remote supply of gambling services is a "zero quota" on the supply of these services. A "zero quota" is a limitation on services trade that is within the scope of Article XVI:2(a) and (c). This limitation is inconsistent with U.S. obligations under Article XVI:1, as well as Article XVI:2(a) and (c).

The second major Panel ruling found that the United States failed to prove that the three Federal statutes are provisionally justified under GATS Article XIV(a) and XIV(c) and also failed to prove that the statutes are consistent with the *chapeau* of Article XIV. Article XIV, entitled "General Exceptions," 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 like conditions prevail, or a disguised restriction on trade in services, nothing in this *Agreement* shall be construed to prevent the adoption or enforcement by any Member of measures:
>
> (a) *necessary* to protect public morals or to maintain public order;
>
> [The footnote, numbered 5, to Paragraph (a) states: "The public order exception may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society."]
>
> (b) necessary to protect human, animal or plant life or health;
>
> (c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this *Agreement* including those relating to:
>
> (i) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on services contracts;
>
> (ii) the protection of the privacy of individuals in relation to the processing dissemination of personal data and the protection of confidentiality of individual records and accounts;
>
> (iii) safety;

> (d) inconsistent with Article XVII, provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members;[551]
> (e) inconsistent with Article II, provided that the difference in treatment is the result of an agreement on the avoidance of double taxation or provisions on the avoidance of double taxation in any other international agreement or arrangement by which the Member is bound.

Article XIV of GATS is an analog to Article XX of GATT. However, the analog contains fewer exceptions than does the GATT provision. In effect, Article XIV(a) (like GATT Article XX(a)), is the "public morals exception" to GATS,

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551. (emphasis added). A lengthy footnote after the word "effective" states:

> Measures that are aimed at ensuring the equitable or effective imposition or collection of direct taxes include measures taken by a Member under its taxation system which:
>
> > (i) apply to non-resident service suppliers in recognition of the fact that the tax obligation of non-residents is determined with respect to taxable items sourced or located in the Member's territory; or
> > (ii) apply to non-residents in order to ensure the imposition or collection of taxes in the Member's territory; or
> > (iii) apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures; or
> > (iv) apply to consumers of services supplied in or from the territory of another Member in order to ensure the imposition or collection of taxes on such consumers derived from sources in the Member's territory; or
> > (v) distinguish service suppliers subject to tax on worldwide taxable items from other service suppliers, in recognition of the difference in the nature of the tax base between them; or
> > (vi) determine, allocate or apportion income, profit, gain, loss, deduction or credit of resident persons or branches, or between related persons or branches of the same person, in order to safeguard the Member's tax base.

Tax terms or concepts in paragraph (d) of Article XIV and in this footnote are determined according to tax definitions and concepts, or equivalent or similar definitions and concepts, under the domestic law of the Member taking the measure.

and Article XIV(c) (like GATT Article XX(d)), is the "administrative necessity exception."

The Panel rendered three specific findings under GATS Article XIV. First, the United States did not demonstrate that the Wire Act, Travel Act, or IGBA are necessary to protect public morals, or to maintain public order, within the meaning of GATS Article XIV(a). Second, the Panel ruled the three Acts are not necessary to comply with existing U.S. laws that are not inconsistent with GATS obligations, within the meaning of Article XIV(c). Third, the Panel concluded that the United States did not prove that the Acts satisfy the requirements of the *chapeau* to Article XIV. These findings, and their fate on appeal, are discussed in turn below.

Fortunately for the United States, on appeal it was able to blunt the full effect of the Panel's rulings under GATS Articles XVI and XIV. That is because the United States successfully argued, as a matter of procedure, that Antigua failed to make a *prima facie* case that the State laws were inconsistent with GATS.[552] The Appellate Body tutored that:

> [t]he evidence and arguments underlying a *prima facie* case, therefore, must be sufficient to identify the challenged measure and its basic import, identify the relevant WTO provision and obligation contained therein, and explain the basis for the claimed inconsistency of the measure with that provision.[553]

Antigua met the first part of the test by showing the full commitment in the U.S. GATS Schedule to the cross-border supply of gambling services. But, Antigua flunked the second part by not connecting the State laws with inconsistency under GATS. The substantive result was dismissal by the Appellate Body of the Panel's verdict that the laws of Louisiana, Massachusetts, South Dakota, and Utah violated GATS Article XVI:2. Indeed, because Antigua did not make out a *prima facie* case against the State laws, the Panel erred in even examining them. On all issues, the rest of the appeal focused on the Federal anti-gambling statutes.

The net effect of the Panel ruling thus set up a classic confrontation, frequent in the GATT context, but new to the GATS: assuming the United States had, in fact, scheduled market access commitments on gambling and gambling services, did its Federal statutes violate those commitments, and if so, was the violation excused by an itemized exception? Put simply, like confrontations between complainants alleging a violation of a pillar GATT obligation, such as in Article I, II, III, or XI, and respondents claiming an exception in Article XX, the *Antigua Gambling* case pitted a claim of market access denial against an exception-based defense.

552. *See Antigua Gambling* Appellate Body Report, *supra* note 542, ¶¶ 133-157, 373(A)(iii).

553. *Id.* ¶ 141.

3. Holdings and Rationale:

a. U.S. Commitments in its GATS Schedule[554]

There was no dispute over the GATS Article XX:3 statement that a Schedule of Specific Commitments for services trade liberalization by a WTO Member is an integral part of the GATS. Rather, at issue was whether the United States previously made a specific commitment on gambling services under sub-sector 10.D of its GATS Schedule. The words "gambling and betting services" do not appear in the American Schedule. Rather, this portion of the Schedule reads:[555]

554. *See id.* ¶¶ 114(B)(i), 158-213, 373(B)(i).

555. Recall that the digits (1, 2, 3, and 4) in the Schedule correspond to the four modes of service sector supply: cross-border supply (Mode I), consumption abroad (Mode II), foreign direct investment (Mode III), and temporary migration (Mode IV). *See* WTO.org, Understanding the WTO: The Agreements – Services: Rules for Growth and Investment, http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm6_e.htm.

| **Sector or subsector** | **Limitations on market access** |
| --- | --- |
| 10. RECREATIONAL, CULTURAL, & SPORTING SERVICES | |
| A. ENTERTAINMENT SERVICES (INCLUDING THEATRE, LIVE BANDS AND CIRCUS SERVICES) | 1) None<br>2) None<br>3) None<br>4) Unbound, except as indicated in the horizontal section |
| B. NEWS AGENCY SERVICES | 1) None<br>2) None<br>3) None<br>4) Unbound, except as indicated in the horizontal section |
| C LIBRARIES, ARCHIVES, MUSEUMS AND OTHER CULTURAL SERVICES | 1) None<br>2) None<br>3) None<br>4) Unbound, except as indicated in the horizontal section |
| D. OTHER RECREATIONAL SERVICES (except sporting) | 1) None<br>2) None<br>3) The number of concessions available for commercial operations in federal, state and local facilities is limited<br>4) Unbound, except as indicated in the horizontal section |

The essence of the U.S. appellate argument was that the United States excluded "sporting" services from this sub-sector. Put simply, by excluding "sporting" services, it thereby excluded gambling services because the former encompasses the latter.

The text of Sub-sector 10.D is "Other recreational services (except sporting)." The Panel said the ordinary lexicographic meaning of "sporting" does not include gambling. The United States urged the Panel misread these words to mean "sporting" does not include gambling. What else could gambling be, but a sport? To some degree, the Appellate Body sympathized with the American view:

> 165. . . . [I]n examining definitions of "sporting," the Panel surveyed a variety of dictionaries and found a variety of definitions of the word. All of the dictionary definitions cited by the Panel define "sporting" as being connected to—in the sense of "related to," "suitable for," "engaged in" or "disposed to"—sports activities. Some dictionaries also define "sporting" as being connected to gambling or betting, but others do not. Of those that do, several note that the word is mainly used in this sense in the phrase "a sporting man," or in a pejorative sense, and some note that the word is used in this sense only when the gambling or betting activities pertain to sports. Based on this survey of dictionary definitions, as well as the fact that "gambling" does not fall within the meaning of the Spanish and French words that correspond to "sporting," namely "déportivos" and "sportifs," the Panel made its finding that "the *ordinary* meaning of 'sporting' does not include gambling."
>
> 166. We have three reservations about the way in which the Panel determined the ordinary meaning of the word "sporting" in the United States' Schedule. First, to the extent that the Panel's reasoning simply equates the "ordinary meaning" with the meaning of words as defined in dictionaries, this is, in our view, too mechanical an approach. Secondly, the Panel failed to have due regard to the fact that its recourse to dictionaries revealed that gambling and betting can, at least in some contexts, be one of the meanings of the word "sporting." Thirdly, the Panel failed to explain the basis for its recourse to the meanings of the French and Spanish words "déportivos" and "sportifs" in the light of the fact that the United States' Schedule explicitly states, in a cover note, that it "is authentic in English only."

Fortunately for Antigua, however, lexicographic analysis of "sporting" was not the end of the Panel's analysis. The Panel considered whether other words in Section 10 of the American Schedule served to make a specific commitment on gambling services. The words "recreational" and "entertainment" could cover gambling, but, said the Panel, dictionaries could not provide a definitive conclusion. Hence, it was necessary to turn to the context, within the meaning of Article 31(2) of the Vienna Convention, in which the United States made its services commitment.[556]

The Panel relied on two key documents from the Uruguay Round that GATT contracting parties used to prepare services Schedules—the "W/120" and "1993 Scheduling Guidelines." At the request of Uruguay Round negotiators, the GATT Secretariat drafted both documents.

The W/120 is formally entitled "Services Sectoral Classification List" and was circulated on 10 July 1991 by the GATT Secretariat. The W/120 is a system for classifying services sectors, based on earlier drafts (including an initial reference list of sectors, "W/50," from April 1989), but is itself a draft subject to further revision via negotiations. As the Appellate Body explained:

> 172. . . . [T]he document [W/120] consists of a table in two columns. The left column is entitled "SECTORS AND SUBSECTORS" and consists of a list classifying services into 11 broad service sectors, each divided into several subsectors (more than 150 in total). The right column is entitled "CORRESPONDING CPC" and sets out, for nearly every subsector listed in the left-hand column, a CPC number to which that subsector corresponds. It is not disputed that the reference in W/120 to "CPC" is a reference to the United Nations' Provisional Central Product Classification. The CPC is a detailed, multi-level classification of goods and services [designed, as its Preface states, to provide a framework for international comparison of statistics dealing with goods, services, and assets and to serve as a guide for developing and revising existing classification schemes of products]. The CPC is *exhaustive* (all goods and services are covered) and its categories are *mutually exclusive* (a given good or service may only be classified in *one* CPC category). The CPC consists of "Sections" (10), "Divisions" (69), "Groups" (295), "Classes"

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556. This provision states:

> 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 connection with the conclusion of the treaty;
> >
> > (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

Vienna Convention on the Law of Treaties, art. 31(2), May 23, 1969, 1155 U.N.T.S. 331, 8 I.L.M. 679 (1969).

> (1,050) and "Subclasses" (1,811). Of the 10 "Sections" of the CPC, the first five primarily classify *products*. They are based on the Harmonised Commodity Description and Coding System, and are not referred to in W/120. The second five Sections of the CPC primarily classify *services*, and all of the references in W/120 are to sub-categories of these five Sections.

The GATT Secretariat circulated the "1993 Scheduling Guidelines" on 3 September 1993 as an "Explanatory Note." The purpose of these documents was to help countries in preparing offers and requests on services trade liberalization, so as to ensure both comparability and clarity in commitments. The Guidelines explain what to put in a Schedule and how to enter them into a Schedule. Significantly, they explain:

> ● The word "None" means a full commitment, i.e., no restrictions on services trade for the relevant sector or sub-sector.
> ● The word "Unbound" is the opposite, meaning no commitment is made to liberalize services trade in the relevant sector or sub-sector.
> ● To make a commitment with limitations, a concise description of each limiting measure should be entered, along with the elements of each measure that make it inconsistent with *GATS* Articles XVI or XVII.

The United States argued that the Panel erred in relying on the W/120 and 1993 Scheduling Guidelines.

In particular, these documents are mere preparatory work. Yet the Panel wrongly elevated them to the status of "context" to be examined as part of the process of interpreting text under the Vienna Convention on the Law of Treaties, including Article 31(1). This provision requires a treaty to be interpreted "in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." The Panel reasoned that because contracting parties in the Uruguay Round delegated to the GATT Secretariat the task of authoring the W/120 and 1993 Scheduling Guidelines, it was reasonable to infer that the documents were part of the agreements made among the WTO Members, or at least agreements made by some of them and accepted by all of them.

"Not so," said the Appellate Body. It is true the United States, like many Uruguay Round participants, used the W/120, and the U.S. Schedule refers to it in two places (though not in a way that delineates clearly the scope of the commitment the United States intended for Sub-sector 10.D). But, as the United States rightly argued, during the Uruguay Round it and other contracting parties stated these documents were non-binding and advisory in nature, but neither a final negotiated outcome nor (as the Preface to the Scheduling Guidelines also states) an authoritative legal interpretation of the GATS. Thus, the Panel erred in categorizing the W/120 and 1993 Scheduling Guidelines as "context" for interpreting the U.S. GATS Schedule.

Nevertheless, the United States lost its appeal on the scheduling issue. The Appellate Body discussion at times seemed to obsess over the proper categorization of documents like the W/120 and 1993 Scheduling Guidelines under the Vienna Convention. The Appellate Body considered three contextual factors—the substantive portions of the GATS, the provisions of covered agreements other than GATS, and the GATS Schedules of other WTO Members. The Appellate Body found all three factors instructive on, but not dispositive of, the issue:

> 180. We move, therefore, to examine the context provided by the structure of the *GATS* itself. The agreement [in Article I:3(b)] defines "services" very broadly, as including "*any* service in *any* sector except services supplied in the exercise of governmental authority." In addition, the *GATS* definition [in Article XXVIII] of "sector" provides that any reference to a "sector" means – unless otherwise specified in a Member's Schedule – a reference to *all* of the subsectors contained within that sector. Many of the obligations in the *GATS* [*e.g.*, Articles VI:1, VIII:1, XVI, and XVII] apply only in sectors in which a Member has undertaken specific commitments. To us, the structure of the *GATS* necessarily implies two things. First, because the *GATS* covers *all* services except those supplied in the exercise of governmental authority, it follows that a Member may schedule a specific commitment in respect of *any* service. Secondly, because a Member's obligations regarding a particular service depend on the specific commitments that it has made with respect to the sector or subsector within which that service falls, a specific service cannot fall within two different sectors or subsectors. In other words, the sectors and subsectors in a Member's Schedule must be mutually exclusive. [As the Appellate Body explained in a footnote, "If this were not the case, and a Member scheduled the same service in two different sectors, then the scope of the Member's commitment would not be clear where, for example, it made a full commitment in one of those sectors and a limited, or no, commitment, in the other."] In the context of the United States' Schedule, this means that, notwithstanding the broad language used in sector 10 – for example, "recreational services," "sporting," and "entertainment services" – gambling and betting services can *only* fall – if at all – within *one* of those service categories.

> 181. Looking beyond the *GATS* to other covered agreements, we observe that Article 22.3(f) of the *DSU* provides that, for purposes of suspending concessions, "'sector' means . . . . (ii) with respect to services, a principal sector as identified in the current 'Services Sectoral Classification List' which identifies such sectors." A footnote adds that "[t]he list in document MTN.GNS/W/120 identifies eleven sectors." This reference confirms the relevance of W/120 to the task of identifying service sectors in *GATS* Schedules, but does not appear to assist in the task of ascertaining within which *subsector* of a Member's Schedule a specific service falls. [Emphases original.]

As to the third contextual dimension, Antigua and the United States agreed—as a logical consequence of GATS Article XX:3—the Schedules of other Members are relevant to discerning the meaning of Subsector 10.D in the U.S. Schedule. The United States emphasized that many WTO Members, but not the United States, refer to CPC codes in their services Schedules. Therefore, it is wrong to presume the U.S. Schedule follows the CPC. The United States also stressed that scheduling gambling services in Sub-sector 10.E, rather than 10.D, was one of several approaches Members accepted.

The American points did not move the Appellate Body. Like almost all WTO Members, the U.S. GATS Schedule generally follows the structure and language of the W/120. The absence of references in the American Schedule to CPC codes does not mean the words in that Schedule must have a different meaning, or scope, from the same words used in the Schedules of other Members. Moreover, several Members specifically use the words "gambling and betting services" in their Schedules. That the United States does not expressly use this phrase undercuts its argument that it intended to single out these services for exclusion from the scope of its commitment. Several Members also made plain, by referring to CPC codes, that their commitments on "sporting services" did not include "gambling and betting services." Conversely, the United States could not cite an example of another Member's Schedule in which the category of "sporting services" clearly encompassed gambling and betting.

As for Sub-sector 10.E, only one Member scheduled gambling and betting in this category, while another expressly excluded it from the category. Further, the Appellate Body wryly remarked, the American argument is contradictory. The same service cannot be covered in two different Sub-sectors of the same Schedule. So, the U.S. argument that the phrase "gambling and betting services" is within the ordinary meaning of Sub-sector 10.D is incongruous with its argument that these services fall (or can fall) under 10.E.

Still, the Appellate Body did not rely on any of the three contextual factors to hold that the United States indeed had made a commitment on "gambling and betting services." From these factors, the Appellate Body said it could not be sure they fell within the ordinary meaning of the term "sporting services," of the term "other recreational services (except sporting)," or possibly of some other term such as "entertainment." Was the object and purpose of GATS—a permissible source under Article 31(1) of the Vienna Convention—helpful? "No," opined the Appellate Body. None of the sources mentioned in Paragraphs (1) or (2) of Article 31 of the Convention used to interpret the "ordinary meaning" of the terms of a treaty "in their context" and in light of the "object and purpose" of the treaty provided a definitive answer as to the ordinary meaning of the relevant services Schedule terms. Therefore, the Appellate Body turned to Paragraph (3) of Article 31, which calls for an examination of "subsequent practice."

Did the "subsequent practice" of WTO Members prove the W/120 and the 1993 Scheduling Guidelines where gambling services fall in a services Schedule? Again, the answer was "no." Citing its opinions in *Japan – Alcoholic Beverages II* and *Chile – Price Band System*, the Appellate Body explained "subsequent practice" under Article 31(3) of the Vienna Convention had two elements: 1) a common, consistent, and discernible pattern of acts or pronouncements and 2) an implication from this pattern of agreement on the interpretation of relevant terms. Antigua pointed to the 2001 Scheduling Guidelines (formally called the "Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services," and numbered S/L/92) as evidence of "subsequent practice." The Appellate Body disagreed. True, the WTO Council for Trade in Services, adopted these "Guidelines" on 23 March 2001. But, it did so in the context of negotiating future—not past—services trade commitments.

Having exhausted the sources listed in Article 31 of the Vienna Convention, the Appellate Body proceeded to Article 32 for guidance on interpreting the meaning of the key words of sub-sector 10.D of the U.S. Schedule, "other recreational services (except sporting)," and discerning whether the United States made a commitment on gambling services in this sub-sector. Article 32 authorizes resort to "supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion." Neither Antigua nor the United States questioned whether W/120 and the 1993 Scheduling Guidelines are "supplementary means," so the Appellate Body proceeded on the assumption that they are.

What do these documents actually say? The relevant portion of W/120 states:

> SECTORS AND SUB-SECTORS CORRESPONDING CPC
>
> [. . .]
>
> 10. RECREATIONAL, CULTURAL AND SPORTING SERVICES (other than audio visual services)
>
> A. <u>Entertainment services</u>

(including theatre, live bands and circus services) 9619
B. News agency services 962
C. Libraries, archives, museums and other cultural services 963
D. Sporting and other recreational services 964
E. Other[557]

Of greatest significance was the specification of CPC 964 in connection with sub-sector 10.D. This CPC grouping embraced the following:

| | |
|---|---|
| 964 | Sporting and other recreational services |
| 9641 | Sporting services |
| 96411 | Sports event promotion services |
| 96412 | Sports event organization services |
| 96413 | Sports facility operation services |
| 96419 | Other sporting services |
| 9649 | Other recreational services |
| 96491 | Recreation park and beach services |
| 96492 | Gambling and betting services |
| 96499 | Other recreational services n.e.c.[558] |

Clearly, included in 964 is 9649, and included in 9649 is 96492. That is, "gambling and betting services" in 96492 are "other recreational services" in 9649 (not "sporting services" in 9641), and thus part of "Sporting and other recreational services" in 964.

Was it, therefore, fair to hold that the United States did schedule a commitment—"None"—on "gambling and betting services" as part of "other recreational services" in sub-sector 10.D of the U.S. GATS Schedule? "Yes," reasoned the Appellate Body. First, there was close linguistic similarity between sub-sector 10.D in the W/120 ("Sporting and other recreational services 964") and sub-sector 10.D in the U.S. GATS Schedule ("Other recreational services (except sporting)").

Second, the document linking the W/120 to the American Schedule was the 1993 Scheduling Guidelines. These Guidelines explain the relationship between the W/120 and the services Schedule of an individual WTO Member:

**HOW SHOULD ITEMS BE SCHEDULED?**

15. Schedules record, for each sector, the legally enforceable commitments of each Member. It is

557. *Antigua Gambling* Appellate Body Report, *supra* note 542, ¶ 198.
558. *Id.* ¶ 201.

therefore vital that schedules be clear, precise and based on a common format and terminology. This section describes how commitments should be entered in schedules . . . .

**A. <u>How to describe committed sectors and subsectors</u>**

16. The legal nature of a schedule as well as the need to evaluate commitments, require the greatest possible degree of clarity in the description of each sector or subsector scheduled. In general the classification of sectors and subsectors should be based on the Secretariat's revised <u>Services Sectoral Classification List</u>. [W/120] Each sector contained in the Secretariat list is identified by the corresponding Central Product Classification (CPC) number. Where it is necessary to refine further a sectoral classification, this should be done on the basis of the CPC or other internationally recognised classification (e.g., Financial Services Annex). The most recent breakdown of the CPC, including explanatory notes for each subsector, is contained in the UN <u>Provisional Central Product Classification</u>.

> <u>Example</u>: A Member wishes to indicate an offer or commitment in the subsector of map-making services. In the Secretariat list, this service would fall under the general heading "Other Business Services" under "Related scientific and technical consulting services" (see item l.F.m). By consulting the CPC, map-making can be found under the corresponding CPC classification number 86754. In its offer/schedule, the Member would then enter the subsector under the "Other Business Services" section of its schedule as follows:
>
> > Map-making services (86754)
> >
> > *If a Member wishes to use its own subsectoral classification or definitions it should provide concordance with the CPC in the*

> *manner indicated in the above example. If this is not possible, it should give a sufficiently detailed definition to avoid any ambiguity as to the scope of the commitment.*[559]

How could the Appellate Body be sure that the United States used the W/120 and sought to follow the 1993 Scheduling Guidelines? One basis, stated colloquially, is that everyone in the Uruguay Round sought to do so. Moreover, several drafts of the American Schedule contained the following telling cover note: "[E]xcept where specifically noted, the scope of the sectoral commitments of the United States corresponds to the sectoral coverage in the Secretariat's Services Sectoral Classification List (MTN.GNS/W/120, dated 10 July 1991)."[560] True, the United States omitted this cover note from its final Schedule. But why is unclear. The Appellate Body did not seem bothered by the omission. It appeared content with a suggestion from the European Communities (EC) that the note was removed as part of technical verification, and the United States could not unilaterally have changed its commitments after 15 December 1993, when Uruguay Round negotiations concluded.[561]

#### b. U.S. Denial of Market Access under GATS Articles XVI:1 and XVI:2(a) and (c)[562]

The Appellate Body began consideration of the market access issue with a useful, brief tutorial of GATS Article XVI:

> Article XVI of the GATS sets out specific obligations for Members that apply insofar as a Member has undertaken "specific market access commitments" in its Schedule. The first paragraph of Article XVI obliges Members to accord services and service suppliers of other Members "no less favourable treatment than that provided for under the terms, limitations and conditions agreed and specified in its Schedule." The second paragraph of Article XVI defines, in six sub-paragraphs, measures that a Member, having undertaken a specific commitment, is not to adopt or maintain, "unless otherwise specified in its Schedule." The first four sub-paragraphs concern quantitative limitations on market access; the fifth sub-paragraph

559. *Id.* ¶ 202 (emphases in original, footnote omitted).
560. *Id.* ¶ 206.
561. *See id.* ¶ 207 n.249.
562. *See id.* ¶¶ 114(C), 214-265, 373(C).

> covers measures that restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and the sixth sub-paragraph identifies limitations on the participation of foreign capital.[563]

Given that the American Schedule included specific commitments on gambling services, did the United States violate those commitments? In particular, were the Wire Act, Travel Act, and IGBA inconsistent with the word "None" in the column on Mode I (cross-border supply) market access of the Schedule?

Framing the question reveals the answer. The word "None" is an undertaking to provide full market access for the relevant services, and not retain any measure listed in Article XVI:2. Antigua argued these Federal statutes violated Article XVI:2(a) and (c). The United States responded that none of the statutes imposed a numerical unit, or took the form of a quota, and thus these sub-paragraphs were inapplicable. The Panel ruled in favor of Antigua. It interpreted the language of sub-paragraph (a), which forbids "limitations on the number of service suppliers . . . in the form of numerical quotas," to encompass a prohibition on one, several, or all means of cross-border delivery. Put simply, a zero quota is a quantitative limit within the scope of Article XVI:2(a).

The Appellate Body agreed. The United States argued unsuccessfully that the Panel holding erroneously leads to the inclusion in GATS Article XVI:2(a) of measures that have the effect of limiting the number of service suppliers (or output) to zero. "Of course," the Panel in essence said any other result would be absurd. From the American perspective, however, including measures having the effect of a zero limit upsets the balance between service trade liberalization and the regulation the GATS embodies. That balance is struck with the key words "in the form of" in Article XVI:2(a). While the Appellate Body accepted the idea that "in the form of" should not be replaced by "have the effect of," the fact is the words "in the form of" are surrounded by words about quantity. The preceding phrase is "limitations on the number of service suppliers," and the subsequent phrase is "numerical quotas." Thus, the thrust of Article XVI:2(a) is not on the "form" of restriction on cross-border service supply, but rather on the numerical or quantitative nature of that restriction. The controversial Federal statutes imposed a zero limit on the supply of cross-border gambling services.

The Appellate Body also agreed with the Panel's reasoning that the fact that the terminology of Article XVI:2(a) and the *chapeau* to the Article contemplate restrictions above zero, does not mean they exclude a zero limitation. To the contrary, terminology embracing a less restrictive limitation (e.g., a quota above zero) can accommodate a more restrictive limitation (e.g., a zero quota). Moreover, Article XVI:2(a) was not drafted with a fully restrictive (zero quota) scenario in mind. If a WTO Member desired a complete prohibition on cross-border supply, then it would not make a commitment in the sector or sub-sector at

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563. *Antigua Gambling* Appellate Body Report, *supra* note 542, ¶ 214.

issue. In turn, there would be no need for that Member to schedule a limitation. Because the United States had made such a commitment, any cutting back on it was a violation.

The Appellate Body was too tentative, however, in drawing this conclusion. It expended three paragraphs (235-237) fretting about the ambiguities of the words "in the form of." As if scared of the accusation that it would be judicially active in interpreting these words, it said it could not render a finding from this language, or from the context, or object and purpose, of GATS. Grasping tightly Articles 31-32 of the Vienna Convention, the Appellate Body said it based its conclusion on the 1993 Scheduling Guidelines. The Guidelines (as stylized on the scheduling issue) were a supplementary means of interpretation, in the form of (pun intended) preparatory work. The Guidelines set out an example of the type of restrictions that would be inconsistent with Article XVI:2(a), assuming a WTO Member made a relevant market access commitment and did not limit the commitment in its Schedule. The example was none other than "nationality requirements for suppliers of services (equivalent to zero quota)." Plainly, a measure equivalent to a zero quota fell within Article XVI:2(a).

Similarly, the Panel ruled that a limitation on the total number of service suppliers (or output) that results in a zero quota violates GATS Article XVI:2(c). The Panel said this provision encompasses three kinds of limitations: a limitation in the form of (1) a designated numerical unit, (2) a quota, or (3) an economic needs test. The Appellate Body agreed. It rejected a somewhat eye-rolling linguistic argument the United States put forward. Surely, the Americans argued, there were only two limitations in Article XVI:2(c), neither of which covers the Federal statutes. The Panel erred in relying on the presence of commas in the French and Spanish versions of GATS, but not in the English version, to find these three limitations:

> The Panel essentially determined that, *notwithstanding* the absence of a comma between "terms of designated numerical units" and "in the form of quotas" in the *English* version, the phrase should, in order to be read in a manner consistent with the French and Spanish versions, be read *as if* such a comma existed – that is, as if expressed in "terms of designated numerical units" and "in the form of quotas" were disjunctive phrases, each of which modifies the word "limitations" at the beginning of the provision. The Panel relied on the fact that such a comma *does* exist in both the French and Spanish versions of the provision. [As the Appellate Body recounted in a footnote: "The French version reads "*limitations concernant le nombre total d'opérations de services ou la quantité totale de services produits, exprimées en unités numériques déterminées, sous forme de contingents ou de l'exigence d'un examen des besoins*

> *économiques*;" and the Spanish version reads "*limitaciones al número total de operaciones de servicios o a la cuantía total de la producción de servicios, expresadas en unidades numéricas designadas, en forma de contingentes o mediante la exigencia de una prueba de necesidades económicas.*"] The United States argues, however, based on a detailed analysis of French grammar, that the existence of the comma in the French version is, in fact, consistent with the absence of a comma in the English version, and that both versions mean that Article XVI:2(c) identifies only *two* limitations.[564]

The Appellate Body replied "surely not:"

> Ultimately, we are not persuaded that the key to the interpretation of this particular provision is to be found in a careful dissection of the use of commas within its grammatical structure. Regardless of which language version is analyzed, and of the implications of comma placement (or lack thereof), *all* three language versions are grammatically ambiguous. All three can arguably be read as identifying two limitations on the total number of service operations or on the total quantity of service output. All three can also arguably be read as identifying *three* limitations on the total number of service operations or on the total quantity of service output. The mere presence or absence of a comma in Article XVI:2(c) is not determinative of the issue before us.[565]

The Appellate Body missed a choice opportunity to craft an appropriately sarcastic reply to the American argument. Instead, it turned the matter into an existential question, eagerly assuming the risk of creating more textual ambiguity than may exist, and eagerly embracing supplementary means of interpretation, namely, the 1993 Scheduling Guidelines. The result? The Appellate Body hesitated to decide whether there were three or two limits in Article XVI:2(c).[566] But, even if there were only two limitations, it does not follow that sub-paragraph (c) would fail to catch a measure equivalent to a zero quota.[567]

Having upheld the Panel's interpretation of sub-paragraphs (a) and (c) of GATS Article XVI:2, the Appellate Body moved to the question of whether the three Federal statutes violated these provisions. Summarizing the Panel's findings in favor of Antigua, the Appellate Body noted:

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564. *Id.* ¶ 244.
565. *Id.* ¶ 245.
566. *Id.* ¶¶ 246-250.
567. *See id.* ¶ 247.

> 259\. . . . [T]he Panel found that "the *Wire Act* prohibits the use of at least one or potentially several means of delivery included in mode 1," and that, accordingly, the statute "constitutes a 'zero quota' for, respectively, one, several or all of those means of delivery." The Panel reasoned that the *Wire Act* prohibits service suppliers from supplying gambling and betting services using remote means of delivery, as well as service operations and service output through such means. Accordingly, the Panel determined that "the *Wire Act* contains a limitation 'in the form of numerical quotas' within the meaning of Article XVI:2(a) and a limitation 'in the form of a quota' within the meaning of Article XVI:2(c)."
>
> . . .
>
> 261\. The Panel determined that "the *Travel Act* prohibits gambling activity that entails the supply of gambling and betting services by 'mail or any facility' to the extent that such supply is undertaken by a 'business enterprise involving gambling' that is prohibited under state law and provided that the other requirements in subparagraph (a) of the *Travel Act* have been met." The Panel further opined that the *Travel Act* prohibits service suppliers from supplying gambling and betting services through the mail (and potentially other means of delivery), as well as services operations and service output through the mail (and potentially other means of delivery), in such a way as to amount to a "zero" quota on one or several means of delivery included in mode 1. For these reasons, the Panel found that "the *Travel Act* contains a limitation 'in the form of numerical quotas' within the meaning of Article XVI:2(a) and a limitation 'in the form of a quota' within the meaning of Article XVI:2(c)."
>
> . . .
>
> 263\. The Panel then determined that because the *IGBA* "prohibits the conduct, finance, management, supervision, direction or ownership of all or part of a 'gambling business' that violates state law, it effectively prohibits the supply of gambling and betting services through at least one and potentially all means of delivery included in mode 1 by such businesses;" that this prohibition concerned service suppliers, service operations and service output; and that, accordingly, the *IGBA* "contains a limitation 'in the form of numerical quotas' within the meaning of Article XVI:2(a) and a limitation 'in the form of a quota' within the meaning of Article XVI:2(c)."

The Appellate Body agreed in full with the Panel. The United States inscribed "None" in the first row of the market access column for sub-sector 10.D.

Therefore, it committed to no restrictions on Mode I of gambling services. The Wire Act, Travel Act, and IGBA do not explicitly use the word "quota," nor do they contain numerical limits. But, they are still within the scope of GATS Article XVI:2(a) and (c). That is because they impose prohibitions on the relevant services. The prohibitions are at variance with these sub-paragraphs, as well as with Article XVI:1.

c. Denial of the U.S. Defense under GATS Article XIV(a) and (c)[568]

Perhaps the most important aspect of the Appellate Body's consideration of the American GATS Article XIV defense was the starting point. The Appellate Body rightly reminded the world trading community of the similarity between this provision (quoted earlier) and GATT Article XX. Both provisions have a *chapeau* that employs similar language, both serve the purpose of providing an "out" from trade-liberalizing obligations on the basis of non-trade concerns, and some of the itemized exceptions in both use the critical term "necessary." Thus, the Appellate Body commenced with the proposition that the jurisprudence of GATT Article XX is relevant to GATS Article XIV. The Appellate Body also demonstrated its sense of history. In Footnote 351 of the Report, it observed that the *Antigua Gambling* case was not only the first one dealing with GATS Article XIV, but was also the first case under any GATT-WTO accord dealing with "public morals." A common law judge could have done no better.

Not surprisingly, therefore, the Appellate Body applied to GATS Article XIV the precedents under GATT Article XX on the two-tier (i.e., two-step) analysis. These precedents are *U.S. – Gasoline* and *U.S. – Shrimp*,[569] as the Appellate Body expressly cited:

> Article XIV of the *GATS*, like Article XX of the GATT 1994, contemplates a "two-tier analysis" of a measure that a Member seeks to justify under that provision [citing the Appellate Body Reports in *Gasoline* and *Shrimp*]. A panel should first determine whether the challenged measure falls within the scope of one of the paragraphs of Article XIV. This requires that the challenged measure address the particular interest specified in that paragraph and that there be a sufficient nexus between the measure and the interest protected. The required nexus – or

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568. *See id.* ¶¶ 114(D), 266-267, 290-372, 373(D).

569. *See* Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R (Apr. 29, 1996); Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R (Oct. 12, 1998).

> "degree of connection" – between the measure and the interest is specified in the language of the paragraphs themselves, through the use of terms such as "relating to" and "necessary to" [citing *Gasoline*]. Where the challenged measure has been found to fall within one of the paragraphs of Article XIV, a panel should then consider whether that measure satisfies the requirements of the *chapeau* of Article XIV.

In sum, Step 1 considers whether the challenged measure—here, the Wire Act, Travel Act, and IGBA—satisfies the criteria in an itemized exception, like sub-paragraph (a) of Article XIV. If the answer is affirmative, then Step 2 considers whether the measure satisfies the *chapeau* criteria. Both steps presume the challenged measure fits within an itemized exception.

The Panel decided that the three Federal statutes were "designed" to protect public morals and maintain public order. Thus, they are within the scope of the exception—a decision essential (whether made expressly or implicitly) to move to Step 1. However, the Panel found they were not "necessary" within the meaning of Article XIV(a). Hence, the measures failed to pass muster under Step 1. Antigua appealed the Panel's decision that the statutes were designed for these purposes. Antigua argued that the Panel did not consider seriously the footnote to Article XIV(a) (numbered 5, and quoted earlier). The Appellate Body easily rejected that argument, thereby upholding the Panel's finding that the statutes did fall within the scope of Article XIV(a).

Of possible long-term consequence is that the Appellate Body left undisturbed the Panel's definition of the terms "public morals" and "order:"

> In its analysis under Article XIV(a), the Panel found that "the term *'public morals' denotes standards of right and wrong conduct maintained by or on behalf of a community or nation*." The Panel further found that the definition of the term "order," read in conjunction with footnote 5 of the *GATS*, "suggests that *'public order' refers to the preservation of the fundamental interests of a society, as reflected in public policy and law*." The Panel then referred to Congressional reports and testimony establishing that "the government of the United States consider[s] [that the *Wire Act*, *Travel Act*, and *IGBA*] were adopted to address concerns such as those pertaining to money laundering, organized crime, fraud, underage gambling and pathological gambling." On this basis, the Panel found that the three federal statutes are "measures that are designed to 'protect

> public morals' and/or 'to maintain public order' within the meaning of Article XIV(a)."[570]

On appeal, therefore, the key issue was whether the Panel was correct in holding that the three Federal statutes failed the "necessity" test of Step 1.

A measure is "necessary," said the Panel, only if all reasonably available WTO-compatible alternatives have been explored and exhausted before adopting the WTO-inconsistent measure. Five points summarize the reasoning of the Panel in ruling that the Wire Act, Travel Act, and IGBA failed this test:[571]

- The three Federal statutes do serve very important societal interests, namely, they are "vital and important in the highest degree."
- These statutes "must contribute, at least to some extent," to addressing American concerns about money laundering, organized crime, fraud, and underage and pathological (compulsive) gambling. The Panel agreed the United States provided evidence specifically linking the remote supply of gambling services, on the one hand, and each of these concerns—except for organized crime—on the other hand. Each of the statutes embodies an outright ban on the remote supply of gambling services. Hence, they contribute to addressing the concerns.
- But, the statutes "have a significant restrictive trade impact."
- The United States rejected the invitation of Antigua to enter into bilateral and multilateral negotiations to explore the possibility of an alternative to the challenged measures that was both WTO-consistent and reasonably available.
- Before imposing its own statutory prohibitions on the cross-border supply of gambling and betting services, the United States had an obligation, according to the definition of "necessity," to explore this possibility. That is, the United States failed to explore and exhaust all reasonably available WTO-consistent alternatives before pursuing its own statutory scheme. That was why the Federal statutes were not "necessary."

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570. *Antigua Gambling* Appellate Body Report, *supra* note 542, ¶ 296 (emphasis added).

571. *See id.* ¶ 301 (quoting Panel Report, *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/R (Nov. 10, 2004) [hereinafter *Antigua Gambling* Panel Report]).

Because the United States could not provisionally justify the disputed measures under GATS Article XX(a), the Panel did not proceed to analyze them under the *chapeau* criteria.

Both Antigua and the United States appealed different aspects of the Panel's finding. Antigua argued that the Panel (1) failed to establish a sufficient nexus between gambling, on the one hand, and the concerns the United States raised, on the other hand, and (2) wrongly limited its consideration to reasonably available alternatives. The United States countered with an appeal of how the Panel examined reasonably available alternatives. The United States said the Panel erroneously imposed a procedural requirement on the United States to negotiate with Antigua before taking measures to protect public morals or maintain public order.

The Appellate Body considered these matters by declaring that the word "necessity" in GATS Article XIV(a) contemplates an objective standard. To determine necessity, the following factors may be examined by studying the objectives and effectiveness of a measure as characterized by the Member defending the measure. The characterizations by the Member exist in texts of statutes, legislative history, and official government pronouncements. But, beyond what the Member says, other factors may be relevant, including contrary evidence by the Member attacking the measure and how the measure operates in practice. The test for "necessity" is a balancing test, as established by the Appellate Body under Article XX(d) in the *Korea – Various Measures on Beef* case: ". . . comprehended in the determination of whether a WTO-consistent alternative measure which the Member concerned could 'reasonably be expected to employ' is available, or whether a less WTO-inconsistent measure is 'reasonably available.'"[572]

Accordingly, the Appellate Body said in three key paragraphs in the *Gambling* case, in which it repeatedly cited its decisions in the *Korea – Beef* and *EC – Asbestos* cases:

> 306. The process begins with an *assessment of the "relative importance" of the interests or values furthered by the challenged measure*. Having ascertained the importance of the particular interests at stake, a panel should then turn to the *other factors that are to be "weighed and balanced."* The Appellate Body has pointed to two factors that, in most cases, will be relevant to a panel's determination of the "necessity" of a measure, although not necessarily exhaustive of factors that might be considered. One factor is the *contribution of the measure to the realization of the ends pursued by it*; the other

572. *Antigua Gambling* Appellate Body Report, *supra* note 542, ¶ 305 (quoting Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Crilled and Frozen Beef*, WT/DS161/AB/R, WT/DS169/AB/R, ¶ 166 (Dec. 11, 2000)).

> factor is the *restrictive impact of the measure on international commerce*.
>
> 307. *A comparison between the challenged measure and possible alternatives should then be undertaken, and the results of such comparison should be considered in the light of the importance of the interests at issue*. It is on the basis of *this "weighing and balancing"* and comparison of measures, taking into account the interests or values at stake, that a panel determines whether a measure is "necessary" or, alternatively, whether another, WTO-consistent measure is "reasonably available."
>
> 308. The requirement, under Article XIV(a), that a measure be "necessary" – that is, that there be no "reasonably available" WTO-consistent alternative – reflects the shared understanding of Members that substantive *GATS* obligations should not be deviated from lightly. An alternative measure may be found not to be "reasonably available," however, where it is merely *theoretical in nature*, for instance, where the responding Member is *not capable of taking it*, or where the measure *imposes an undue burden on that Member*, *such as prohibitive costs or substantial technical difficulties*. Moreover, a "reasonably available" alternative measure must be a measure that would *preserve for the responding Member its right to achieve its desired level of protection* with respect to the objective pursued under paragraph (a) of Article XIV.[573]

These paragraphs leave no doubt that GATS Article XIV, like GATT Article XX, is about balancing competing values. By implication, they also leave no doubt that the WTO judiciary, as it were, plays a major, even decisive, role in the balancing. Finally, conceptually, they lay out a five-part method for applying the balancing test:

- Identification of the relative importance of the interests or values, i.e., the ends the challenged measure advances, such as protecting public morals or keeping public order.
- Identification of other factors, including the (1) extent to which the measure contributes to these ends, and (2) trade-restrictive effects of the measure.
- Balancing of the ends of the measure against other factors.

573. Emphasis added.

> ● Consideration of possible less trade-restrictive alternatives than the challenged measure that are reasonably available, i.e., not theoretical or unduly burdensome, which would achieve the ends of the challenged measure and which are WTO-consistent.
> ● Comparison of the challenged measure against reasonably available alternatives, i.e., balancing the measure and the alternatives.

The methodology actually entails two trips to the scales of justice. First, the goal of the challenged measure, in terms of the interests or values it serves, is weighted against other factors. Second, the challenged measure is weighted against other options.

Additionally, the burden of proof in applying this methodology is split. On the first three points, the respondent—here, the United States—bears the burden of proof to show "necessity" of the challenged measure to achieving public morals or maintaining public order. On the latter two points, the complainant—here, Antigua—bears the burden of proving that a less trade-restrictive measure is reasonably available. If the complainant does so, then the burden of rebuttal shifts to the respondent. Thus, the Appellate Body stated:

> 310. . . . it is for a responding party to make a *prima facie* case that its measure is "necessary" by putting forward evidence and arguments that enable a panel to assess the challenged measure in the light of the relevant factors to be "weighed and balanced" in a given case. The responding party may, in so doing, point out why alternative measures would not achieve the same objectives as the challenged measure, but it is under no obligation to do so in order to establish, in the first instance, that its measure is "necessary." If the panel concludes that the respondent has made a *prima facie* case that the challenged measure is "necessary" – that is, "significantly closer to the pole of 'indispensable' than to the opposite pole of simply 'making a contribution to'" [citing *Korea Beef*] – then a panel should find that challenged measure "necessary" within the terms of Article XIV(a) of the *GATS*.
>
> 311. If, however, the complaining party raises a WTO-consistent alternative measure that, in its view, the responding party should have taken, the responding party will be required to demonstrate why its challenged measure nevertheless remains "necessary" in the light of that alternative or, in other words, why the proposed alternative is not, in fact, "reasonably available." If a responding party demonstrates that the alternative is not "reasonably available," in the light of the interests or values being pursued

> and the party's desired level of protection, it follows that the challenged measure must be "necessary" within the terms of Article XIV(a) of the *GATS*.

This bifurcation is important because it assures WTO Members in the respondent's position that they need not prove the negative, i.e., identify the universe of alternatives and show none applies.

Applying this methodology, the Appellate Body elected to overrule the Panel on the Article XIV(a) issue, i.e., on Step 1. Siding with the United States, the Appellate Body agreed the Wire Act, Travel Act, and IGBA fell within the scope of sub-paragraph (a) and satisfied the criteria for this itemized Article XIV exception to GATS obligations. Proceeding to Step 2, the Appellate Body examined whether the three Federal statutes satisfied the requirements of the *chapeau*. Unfortunately for the United States, the Appellate Body ruled they did not.

In its Step 1 analysis, the Appellate Body characterized the outcome of the Panel stage as:

> *but for* the United States' alleged refusal to accept Antigua's invitation to negotiate, the Panel would have found that the United States had made its *prima face* case that the *Wire Act*, the *Travel Act*, and the *IGBA* are "necessary," within the meaning of Article XIV(a).[574]

On appeal, the Appellate Body essentially echoed the American argument. The Panel's definition of "necessity" imposed on the United States a procedural requirement to consult or negotiate with Antigua before taking measures to protect public morals or maintain public order. Surely, "necessity" is a property of a measure itself and cannot be determined by referring to the efforts a WTO Member does or does not undertake to negotiate an alternative. Moreover, citing previous cases, the theoretical availability of alternative measures has not precluded a challenged measure from being deemed "necessary." Thus, the Appellate Body opined:

> In our view, the Panel's "necessity" analysis was flawed because it did not focus on an alternative measure that was reasonably available to the United States to achieve the stated objectives regarding the protection of public morals or the maintenance of public order. Engaging in consultations with Antigua, with a view to arriving at a negotiated settlement that achieves the same objectives as the challenged United States' measures, was not an

574. *Antigua Gambling* Appellate Body Report, *supra* note 542, ¶ 317 (emphasis added).

> appropriate alternative for the Panel to consider because *consultations are by definition a process, the results of which are uncertain and therefore not capable of comparison with the measures at issue in this case*.[575]

Having ruled that the Panel was wrong to find the Federal statutes unnecessary without first consulting or negotiating with Antigua, the Appellate Body considered whether the statutes, in their own right, were "necessary."

The answer was a clear "yes." As the Panel itself recounted, and as noted earlier, the U.S. statutes protect important societal interests, which may need protection through strict controls, and contribute to this protection. While they have a significant trade-restrictive impact, this impact is tempered by characteristics of the remote supply of gambling. These features include the large volume, high speed, international reach, and virtual anonymity of remote gambling transactions, the isolated environment in which these transactions occur, and the low barriers to entry to provide remote supply services. Thus, the Panel—said the Appellate Body—was not off the mark by calling the statutes "indispensable."[576] Given the provisional justification of the statutes under Article XIV(a), the Appellate Body also ruled that it need not determine whether Article XIV(c) justifies them as well.

Proceeding to Step 2, the Appellate Body considered whether the Wire Act, Travel Act, and IGBA comport with the requirements of the *chapeau* of GATS Article XIV. The essence of the *chapeau* requirements is that a measure is applied in a manner that is not "arbitrary" or "unjustifiable" discrimination among countries in which like conditions prevail, or a "disguised restriction on trade in services." There was no doubt the language of the statutes was facially neutral. They did not distinguish between domestic and foreign suppliers of remote gambling services. The Appellate Body rejected Antigua's argument that the Panel acted improperly by analyzing the U.S. defense under the *chapeau*. The jurisprudence under GATT Article XX, notably, *Korea – Various Measures on Beef*, does not forbid a panel from evaluating a defense once the panel determines a challenged measure is not provisionally justified under an itemized exception in Article XX. A panel enjoys freedom to decide which legal issues to address to resolve a dispute. The Appellate Body also rejected Antigua's argument that the Panel erred by focusing its *chapeau* analysis on the remote supply of gambling services rather than the entire gambling industry. To the contrary, the Panel was right to segment the gambling industry into remote and non-remote supply because remote supply is at issue in the case at bar.

What, then, was the problem with the Panel's work—from the American perspective? The Panel held that the United States failed to apply its statutory prohibitions in a consistent manner as between domestic and foreign suppliers of

575. *Id.* (emphasis added).

576. *Id.* ¶ 323 (quoting *Antigua Gambling* Panel Report, *supra* note 571).

remote gambling services. The Panel relied on two points: 1) enforcement of the three disputed federal statutes and 2) a related fourth federal statute.

First, the United States had not prosecuted certain domestic remote gambling service suppliers under the Wire Act, Travel Act, and IGBA. But, the United States did enforce these measures against foreign suppliers. Therein lay *de facto* discrimination.

Second, a fourth federal statute—the 1978 Interstate Horseracing Act (IHA)—could be interpreted (*prima facie*) to permit remote betting on horse-racing within the United States [577] Quoting from the IHA statute, the Appellate Body explained the gist of the IHA and Antigua's argument:

> . . . Before the Panel, Antigua relied on the text of the *IHA*, which provides that "[a]n interstate off-track wager *may be accepted* by an off-track betting system" where consent is obtained from certain organizations. Antigua referred the Panel in particular to the definition given in the statute of "interstate off-track wager:"
>
>> [T]he term . . . 'interstate off-track wager' means a legal wager placed or accepted in one State with respect to the outcome of a horserace taking place in another State and includes pari-mutuel wagers, where lawful in each State involved, *placed or transmitted by an individual in one State via telephone or other electronic media and accepted by an off-track betting system in the same or another State*, as well as the combination of any pari-mutuel wagering pools.[578]

Thus, according to Antigua, the IHA, on its face, authorizes *domestic* service suppliers, but not *foreign* service suppliers, to offer remote betting services in relation to certain horse races. To this extent, in Antigua's view, the IHA "exempts" domestic service suppliers from the prohibitions of the Wire Act, the Travel Act, and the IGBA. The Panel agreed that a *prima facie* reading of the IHA indicates that it permits interstate pari-mutuel wagering over the phone, internet, or other electronic means, as long as such wagering is lawful in both states. Thus, concluded the Panel:

> . . . the United States has not demonstrated that it applies its prohibition on the remote supply of these services in a *consistent manner* as between those supplied domestically and those that

577. Interstate Horseracing Act, 15 U.S.C. §§ 3001-3007 (2000).

578. *Antigua Gambling* Appellate Body Report, *supra* note 542, ¶ 361 (quoting *Antigua Gambling* Panel Report, *supra* note 571) (emphasis added).

> are supplied from other Members. Accordingly, we believe that the United States has not demonstrated that it does not apply its prohibition on the remote supply of wagering services for horse racing in a manner that does not constitute "arbitrary and unjustifiable discrimination between countries where like conditions prevail" and/or a "disguised restriction on trade" in accordance with the requirements of the *chapeau* of Article XIV.[579]

From the American perspective, the Panel erroneously made the Article XIV *chapeau* language more timorous than it is.

In particular, argued the United States on appeal, "consistency" is not the same as "arbitrary" or "unjustifiable." Any differential treatment can lead to a finding of inconsistency, but inconsistency does not mean the differential is arbitrary or unjustified discrimination. The Wire Act, Travel Act, and IGBA do not discriminate in the way in which they are applied to the remote supply of gambling services. They prohibit such supply whether the supplier is domestic or foreign.

The Appellate Body disagreed with the American view of how the Panel read the *chapeau*. It said the Panel did not ignore the descriptive adjectives in the *chapeau* and thus did not equate them with "inconsistency." But, the Appellate Body agreed with the U.S. assertion the Panel was wrong to rule that the facts about enforcement of the disputed measures were inconclusive to establish non-discrimination. In other words, as to the two points on which the Panel relied, the Appellate Body rejected the first and accepted the second.

The Appellate Body recounted that at the Panel stage, Antigua rebutted the U.S. argument that its statutes did not discriminate at all. Antigua showed that domestic service suppliers are permitted to provide remote gambling services in situations in which foreign suppliers cannot. Antigua identified four American firms engaged in the remote supply of gambling services that had not been prosecuted under any of the three disputed federal statutes—Youbet.com, TVG, Capital OTB, and Xpressbet.com. In contrast, an Antiguan service supplier, using the same business model as Capital OTB, was prosecuted and convicted under the Wire Act. The United States responded that a prosecution was underway against Youbet.com, but it could not persuade the Panel that enforcement actions against the other firms were pending. The Appellate Body looked at this record and held that the Panel's conclusion rested on an inadequate evidentiary foundation.

Five cases—one prosecution of an Antiguan supplier, one pending prosecution of an American supplier, and three instances of no evidence of prosecution—are not enough to be sure that Antigua rebutted the American defense of non-discriminatory enforcement. The Appellate Body intoned:

579. *Id.* ¶ 348 (quoting *Antigua Gambling* Panel Report, *supra* note 571).

> In our view, the proper significance to be attached to isolated instances of enforcement, or lack thereof, cannot be determined in the absence of evidence allowing such instances to be placed in their proper context. Such evidence might include evidence on the *overall* number of suppliers, [] on *patterns* of enforcement, and on the reasons for particular instances of non-enforcement. Indeed, enforcement agencies may refrain from prosecution in many instances for reasons unrelated to discriminatory intent and without discriminatory effect.[580]

Given the dearth of evidence, what should the Panel have done? The Appellate Body said it should have "focused, as a matter of law, on the wording of the measures at issue. These measures, on their face, do *not* discriminate between United States and foreign suppliers of remote gambling services."[581] In other words, the Appellate Body returned to the time-honored GATT tradition of distinguishing between *de facto* and *de jure* discrimination. There was insufficient evidence to make out a case of discrimination in fact, so the Panel ought to have looked for discrimination at law. The Appellate Body did so as to the Wire Act, Travel Act, and IGBA, and found none. Thus, the Appellate Body reversed the finding of the Panel that the United States had failed to demonstrate that enforcement of these three statutory prohibitions was inconsistent with the *chapeau* of GATS Article XIV.

Yet, the United States lost the appeal with respect to Step 2 in the two-step methodology used in GATS Article XIV and GATT Article XX cases. Why? The short answer is "horseracing." On its face, the IHA authorizes domestic, but not foreign, service suppliers to offer remote betting on certain horse races. The effect of this authorization is to exempt domestic service suppliers from the prohibitions of the Wire Act, Travel Act, and IGBA. The United States unsuccessfully countered, at both the panel and appellate stages, that there could be no such exemption. A civil statute cannot repeal by implication the other three statutes, each of which is criminal. Only an express repeal by Congress could create that effect.

The United States could not persuade either the Panel or Appellate Body that the remote supply of horseracing wagering services by domestic firms is prohibited, notwithstanding the plain language of the IHA. The Appellate Body agreed with Antigua, and upheld the Panel's view of the IHA—its wording is ambiguous as to its scope of application and its relationship to the Wire Act, Travel Act, and IGBA. In turn, the United States failed to prove that it did not discriminate in an arbitrary, unjustifiable manner with respect to these services. The "bottom line" was that the IHA creates the possibility of exempting only

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580. *Id.* ¶ 356.
581. *Id.* ¶ 357.

domestic firms from the other three federal statutes, and thus creates the possibility that only domestic firms could provide these services.

In sum, the Appellate Body issued three conclusions under GATS Article XIV. First, it reversed the Panel's conclusion under Step 1 of the two-step Article XIV test. The Wire Act, Travel Act, and IGBA are provisionally justified as necessary to protect public morality under Article XIV(a). Second, under Step 2, it reversed the Panel's finding that the United States enforced these statutes in a *de facto* discriminatory manner. Third, also under Step 2, it upheld the Panel's conclusion that the IHA may alter the scope of application of the prohibitions in the other three statutes as to domestic suppliers of remote betting on horse races. This alteration may exempt them from the prohibitions and thus discriminate against provision of these services by foreign suppliers.

### 4. Commentary

#### a. Disappointing

The *Antigua Gambling* case disappoints any reader searching for a marvelous discussion of trade and morality. The Report is devoid of such discussion. Perhaps it is unrealistic to expect one, given the technical legal issues and arguments at stake. Still, the Appellate Body worked vigorously to avoid any normative issue, evidently preferring to keep matters framed in a way to avoid anything "too deep," as it were.[582]

The fact remains that animating in the American defense under GATS Article XIV(a) is a fundamental question of whether restrictions on gambling and

582. For a discussion of broad social values that GATT Article XX(a) can be used to promote, see Steve Charnovitz, *The Moral Exception in Trade Policy*, 38 VA. J. INT'L L. 689, 689-732 (1998). For another treatment, see Christoph T. Feddersen, *Focusing on Substantive Law in International Economic Relations: The Public Morals of GATT's Article XX(a) and "Conventional" Rules of Interpretation*, 7 MINN. J. OF GLOBAL TRADE 75, 75-101 (1998).

Some recent work asserts, albeit confusingly, that the Appellate Body interprets Articles III and XX in a way to create a risk that these provisions are becoming tools to mandate de-regulation. *See* PETROS C. MAVROIDIS, THE GENERAL AGREEMENT ON TARIFFS AND TRADE: A COMMENTARY 208-09 (2005). Whether that is a risk, or a key purpose of GATT contributing to its historical success in liberalizing trade, is an important distinction. Moreover, the assertion itself is debatable, as is the related point that sub-paragraph (a) is the only exception in Article XX that could reduce substantially or eliminate the risk. A no less unfortunate aspect of this recent work is the suggestion that Article XX(a) is susceptible only to 1) open-ended construal, as a public order exception, or 2) a narrow construction based on preparatory work (*travaux préparatoires*). The provision is not bi-polar. What might be helpful is an approach less in the way of conventionality, which (written clearly) would include philosophical, even theological, perspectives on morality in the context of international trade.

betting services are acceptable on moral grounds. The Appellate Body, of course, decides in the affirmative without grounding its rationale in morality. That is a pity. It might have thought laterally, pointing out, for example, the Islamic principles against gambling, and drawing on other religious or philosophical premises to buttress its holding. In other words, the Appellate Body passed up an opportunity to be grand.

b. Somewhat Better Writing

Perusal of the Appellate Body Report in *Antigua Gambling* is a study in modest contrast with the Reports in *Cotton* and *Sugar*. The Appellate Body wrote clearly and concisely in *Antigua Gambling*. Indeed, the Report is comparatively more enjoyable to read. True, there are frustrating moments when what might well be straightforward questions are turned into metaphysically ambiguous matters dependent on source characterization or comma placement. The last several paragraphs, including the critical ones on the overall conclusion under Article XIV (especially paragraph 371), contain run-on sentences, double negatives, and awkward wording. Still, overall, redundancy is minimized, as is the use of stock phrases and sentence structures. The Appellate Body resorts to different turns of phrase to make points in a powerful, interesting manner. There also is a tonal difference. In *Antigua Gambling*, the Appellate Body sounds more confident, even assertive at appropriate points, at ruling in favor or against arguments, than it does in its *Cotton* and *Sugar* Reports.

c. Unnecessary Overtime?

As suggested, the principal fault with the *Antigua Gambling* Report is its tentativeness. Here is an Appellate Body reveling in ambiguity, running from its role as the *de facto* supreme court (subject to oversight by the Member-driven Dispute Settlement Body) of multilateral trade rules in the formative era of the WTO judiciary. Thus, arguably, the Appellate Body worked too hard to reach its holding on the first issue. It spent considerable time on deciding what the W/120 and 1993 Scheduling Guidelines are under the Vienna Convention. Yet, the CPC groupings, particularly 96492, provide a clear indication that gambling services come within "other recreational services," and, therefore, in sub-sector 10.D of the W/120. Might the Appellate Body have gone straight to this point, noting briefly that whether the W/120 provides context to the GATS or supplementary means, the result is the same?

d. Right and Wrong?

Is the Appellate Body ruling on GATS Article XIV(a) correct as to Step 1 but mistaken as to Step 2? Its reasoning in Step 1 could be strengthened. Imposing a procedural requirement of prior consultation or negotiation would be an unacceptable intrusion on the sovereignty of a WTO Member. It would amount to telling a Member not only what to do, but also how to do it. Careful observers of the WTO accession package for the Kingdom of Saudi Arabia will note that Annex F to the Saudi Protocol contains numerous invocations by the Kingdom of GATT Article XX(a). This exception justifies the import ban on alcohol and pork, for example. Imagine the uproar in the Kingdom if it had to negotiate with exporters of alcohol and pork to find a reasonably available WTO-consistent alternative before it was allowed to invoke Article XX(a).

But, as to Step 2, the Appellate Body may have brought matters to a premature close. One reading of the Step 2 analysis is that the entire case turns on what might be possible under the IHA. The Appellate Body seems to have granted no deference to the U.S. reading of its own statutes. Whether, in truth, the IHA gives domestic suppliers of remote betting on horse racing an advantage by exempting them, but not foreign suppliers, from the Travel Act, Wire Act, and IGBA, surely is a matter the United States knows well. Even the Panel and Appellate Body could not conclude with certainty that the playing field for providing remote gambling services on horse races was unbalanced. The best they could do was assert that the United States did not prove its case. Query what proof is needed beyond the truism under the U.S. Constitution that only an Act of Congress or final judicial determination could grant the exemption the judges in Geneva say might exist?

#### e. No Compliance Thus Far

As of spring 2006, the roar of the mouse was heard with little effect in Washington, D.C. That is a pity. Compliance with WTO adjudicatory outcomes in cases pitting large and small countries is a good test of the commitment of the former group to the international rule of law, at least in trade matters. This noncompliance is also somewhat incongruous with America's overall record of compliance, at least early in WTO history, with small-country victories. (The Costa Rica Underwear case, *United States – Restrictions on Imports of Cotton and Man-made Fibre Underwear*, WT/DS24/AB/R (adopted 25 February 1997), is a modest example. Compliance was immediate, albeit by virtue of non-renewal of the disputed textile import restrictions.) Anticipating or fearing non-compliance, the mouse, Antigua—led by private counsel—has threatened the United States with sanctions that would be both punitive and creative. Two bills had been introduced in Congress, but neither of them, said Antigua, came close to compliance with the Appellate Body recommendations, or the 3 April deadline for compliance.[583]

The first bill, H.R. 4777 (titled the Internet Gambling Prohibition Act), was introduced on 19 February 2006 by Rep. Bob Goodlatte (Republican – Virginia). This bill would amend the Wire Act to cover all forms of interstate gambling and encompass new technologies, thereby specifically prohibiting internet gambling (as the Wire Act bars gambling over phone lines). The second bill, H.R. 4411, was introduced by Rep. Jim Leach (Republican – Iowa) on 18 November 2005. This bill would prohibit use of credit cards, funds transfers, and other payment methods for illegal internet gambling, though it would not itself make such gambling unlawful.

Neither bill, argued Antigua, complies with the Appellate Body recommendations. Both of them exclude from their scope (1) any transaction made in compliance with the IHA, (2) intra-state transactions, thus allowing remote gambling occurring wholly within the United States, and (3) remote gambling conducted by Native American tribes under Federal law.[584] Plainly, neither bill, said Antigua, would eliminate discrimination against foreign suppliers of remote gambling services. Indeed, they could exacerbate the distinction between domestic and foreign suppliers.

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583. *See* Pruzin, *Gambling Dispute*, *supra* note 544; Alan Beattie, *Antigua Accuses U.S. Over WTO Ruling on Gambling*, FIN. TIMES, Feb. 20, 2006, at 4.

584. *See* Pruzin, *Gambling Dispute*, *supra* note 544.