BEFORE THE
WORLD TRADE ORGANIZATION
APPELLATE BODY

Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes

(AB-2005-3)

THIRD PARTICIPANT SUBMISSION OF THE UNITED STATES OF AMERICA

February 18, 2005

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TABLE OF REPORTS CITED

SHORT TITLE	FULL TITLE AND CITATION
Canada – Wheat	Panel Report, *Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain,* WT/DS276/R, adopted 27 September 2004
EC – Asbestos	Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001
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Korea – Various Measures on Beef	Panel Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/R, WT/DS169/R, adopted 10 January 2001
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United States – Section 337 (GATT)	GATT Panel Report, *United States – Section 337 of the Tariff Act of 1930*, L/6439, adopted 7 November 1989, BISD 36S/345

I. INTRODUCTION

1. The United States welcomes this opportunity to present its views to the Appellate Body regarding the appeals of the Dominican Republic and Honduras. As it did before the Panel, the United States takes no position with respect to the WTO-consistency of the measures at issue. Rather, the United States has a systemic interest in the interpretation and application of certain of the provisions of the covered agreements before the Appellate Body. In this submission the United States would like in particular to address certain points concerning Articles III:4 and XX(d) of the *General Agreement on Tariffs and Trade 1994* ("GATT 1994").

II. THE PANEL'S INTERPRETATION OF "NECESSARY" IN ARTICLE XX(d) ADDS TO AND DIMINISHES RIGHTS AND OBLIGATIONS PROVIDED IN THE GATT 1994

2. The United States notes that the Panel and the Dominican Republic appear to agree on the basic standard to be applied in determining whether a measure is "necessary" under Article XX(d) of the GATT 1994.[1] As the Appellate Body has previously noted, and as accepted by both the Panel and the Dominican Republic, "'necessary' normally denotes something 'that cannot be dispensed with or done without, requisite, essential, needful'."[2] However, "the word 'necessary' is not limited to that which is 'indispensable' or 'of absolute necessity' or 'inevitable.'"[3]

3. The Panel acknowledged what the Appellate Body has noted in previous disputes, namely that the necessity of a measure is to be evaluated by "weighing and balancing" several factors, including: (1) the relative importance of the common interests or values that the law or regulation is intended to protect; (2) the extent to which the measure contributes to the realization of the end pursued, the securing of compliance with the law or regulation at issue; and (3) the restrictive impact of the measure on imported goods.[4] In addition, the Panel recognized that the reasonable availability of measures not inconsistent with the GATT is part of an Article XX(d) "weighing and balancing" analysis.[5]

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[1] *See* Panel Report, paras. 7.213-7.214 and 7.227; *see also* Appellant's Submission of the Dominican Republic, paras. 30-31.

[2] *Korea – Various Measures on Beef,* Appellate Body Report, para. 160.

[3] *Id.*, para. 161.

[4] *See* Panel Report, para. 7.214; *see also Korea – Various Measures on Beef*, Appellate Body Report, para. 164; *Canada – Wheat*, Panel Report, paras. 6.222-6.223.

[5] *See* Panel Report, para. 7.227; *see also* Appellant's Submission of the Dominican Republic, para. 47; *Korea – Various Measures on Beef*, Appellate Body Report, para. 165, *citing United States – Section 337*, GATT Panel Report, para. 5.26.

4. As mentioned above, the United States takes no view in this proceeding with respect to the Panel's analysis and conclusions regarding the Tax Stamp Requirement (the measure at issue in the Dominican Republic's appeal) and whether it is "necessary" under Article XX(d). However, the United States believes that the Panel departed in its analysis from the interpretation that it articulated for determining whether a measure is "necessary," and added conditions that are not part of the ordinary meaning of the term, in context, and in light of the object and purpose of the GATT 1994. As a result, the Panel's interpretation is not in accord with customary rules of interpretation of public international law.

5. First, the United States considers incorrect the notion that Article XX(d) requires a Member to select a less GATT-inconsistent alternative, where no GATT-consistent alternative measure is available. There is nothing in the ordinary meaning of "necessary" that would refer to degrees of inconsistency with the GATT 1994. Indeed, the concept of degree of inconsistency with an agreement would be a very complicated and detailed concept that could in no way be related to the ordinary meaning of "necessary," nor is there any context in the GATT 1994 or other WTO agreements that would support importing such a concept into the ordinary meaning of "necessary." If anything, the context would strongly support the opposite conclusion.[6] Accordingly, the Panel's interpretation has no support in the text of the GATT 1994. Aside from having no basis in the GATT 1994 (or any other WTO agreement), such a requirement is unworkable in practice. Measures are either consistent or inconsistent with the GATT 1994; it is logically impossible to discern degrees of GATT-inconsistency, much less to administer a rule requiring Members to do so. At most, an analysis of "reasonably available" alternatives should entail an examination of whether an alternative measure that is not inconsistent with the GATT 1994 is indeed "reasonably available". To the extent it endorses the idea that Members are required to use less GATT-inconsistent alternative measures,[7] the Panel has incorrectly described the obligations imposed by Article XX(d).

6. The Panel states that the Dominican Republic "has not discharged its duty to prove why other, reasonably-available, less-GATT inconsistent, measures would not be able to achieve that same level of enforcement."[8] Yet the types of measures the Panel suggests as possible alternatives – providing secure tax stamps to exporters or arranging for pre-shipment inspection and certification – cannot be less GATT-inconsistent for the simple reason that measures are either consistent or inconsistent with the GATT. The Panel made no finding that such

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[6] See discussion below of the *Agreement on the Application of Sanitary and Phytosanitary Measures* (Article 5.6) and the *Agreement on Technical Barriers to Trade* (Article 2.2).

[7] *See* Panel Report, paras. 7.227-7.228.

[8] *Id.*, para. 7.228.

alternatives would result in no "additional processes and costs" on imported products, which was a key basis for the Panel's finding of an inconsistency with Article III:4.[9] In fact, under the Panel's reasoning, such alternatives would almost certainly be GATT-inconsistent because, like the Tax Stamp Requirement, they would accord imports "less favourable treatment" by "impos[ing] additional processes and costs on imported products" and thereby modify the conditions of competition to the detriment of imports.[10] And not only would they be inconsistent with the GATT 1994, they would be inconsistent, according to the Panel, with the very same provision of the GATT 1994 – Article III:4. It is thus impossible to say that one breach of GATT Article III:4 would be "less" inconsistent with the GATT 1994 than a breach of the same Article.

7. The Panel appears to prefer these alternatives not because they are "less GATT-inconsistent", but because in the Panel's view they may be "less trade-restrictive". The Panel even equates the two concepts, stating that "as part of an alternative which would be less trade-restrictive, Honduras proposed that the Dominican Republic could resort to pre-shipment inspection and certification . . .."[11] In so doing, the Panel essentially imports into Article XX(d) a requirement that a Member also use a less trade-restrictive alternative, if one is available. Yet there is no basis in the GATT 1994 for the Panel to do so. The concept of "less trade-restrictive"

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[9] *Id.*, para. 7.196. While the Dominican Republic has not appealed the Panel's finding with respect to Article III:4, the United States wishes to make an observation regarding the Panel's analysis. In particular, although Article III:4 relates to "internal" measures, *Note Ad* Article III of the GATT 1994 provides that such measures may be applied at the point of importation, i.e., the border. The United States has serious concerns with the Panel's finding. To the extent the Panel's finding of "less favourable treatment" is premised on the fact that imposing the measure at the border means additional "processes and costs" for imported products, it would appear to be difficult to reconcile with the fact that, as recognized by the *Note Ad* Article III, Members are permitted to apply their internal measures at the border. Moreover, Article III:4 does not require the elimination of every perceived difference between imported and domestic products nor to equalize costs between them. Requiring that measures not alter the "conditions of competition" between domestic and imported products such that imported products are treated less favorably is not the same as requiring that measures ensure that imported products bear no greater cost than domestic products. As the Appellate Body has recognized, such "incidental effects" might not have "decisive implications" for whether a measure is inconsistent with Article III:4. *Korea – Various Measures on Beef*, para. 141.

[10] In this connection, the United States notes the Panel's citing with approval to the proposal for "pre-shipment inspection and certification, through a reputable company, *at the expense of the importer*." Panel Report, para. 7.228 [emphasis added]. The Panel appears to assume then that there would be additional costs for imported products.

[11] *Id.*, para. 7.228.

alternative measures arises only in the context of two WTO agreements, in which it was expressly negotiated: the *Agreement on the Application of Sanitary and Phytosanitary Measures* (the "SPS Agreement") and the *Agreement on Technical Barriers to Trade* (the "TBT Agreement").[12] It is error for the Panel to attempt to retrofit this concept into Article XX(d), particularly since it is clear that these concepts are separate and distinct from the concept of "necessary".[13] And since this is a requirement that is not in the text, it is "adding to" the obligations of Members, and "diminishing" the rights of Members under the covered agreements, which is prohibited under Articles 3.2 and 19.2 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes*.

8. Second, the United States notes the Panel's statement that "[t]he Panel thus finds no evidence to conclude that the tax stamp requirement secures a zero tolerance level of enforcement with regard to tax collection and the prevention of cigarette smuggling."[14] The Panel did not explain how this was relevant to its analysis of "alternative measures" under Article XX(d). Nor should the fact that it is not possible to achieve 100 percent compliance with a law by itself render that law "unnecessary." The Panel thus distorts the meaning of the term "necessary" under Article XX(d).

9. Finally, under the GATT 1994, each WTO Member retains the right to determine the level of protection it seeks from various risks. The Appellate Body and previous panels have reinforced this view in numerous contexts.[15] As such, an analysis of whether a "reasonably available" alternative to a challenged measure exists must not impinge this right.[16] An

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[12] *See* SPS Agreement, Article 5.6; *see also* TBT Agreement, Article 2.2.

[13] See SPS Agreement Article 2.2, which refers to "necessary" to protect human, animal, or plant life or health, which is based on the language in GATT 1994 Article XX(b), analogous to Article XX(d). If "necessary" equates to "least trade-restrictive" then SPS Agreement Article 5.6 would be rendered inutile, indicating that this in fact is not the correct interpretation of "necessary."

[14] Panel Report, para. 7.229.

[15] *See EC – Asbestos*, Appellate Body Report, para. 168; *see also Korea – Various Measures on Beef*, Appellate Body Report, para. 176 ("It is not open to doubt that Members of the WTO have the right to determine for themselves the level of enforcement of their WTO-consistent laws and regulations."); *Canada – Wheat*, Panel Report, para. 6.226.

[16] *See United States – Section 337*, GATT Panel Report, para 5.26 ("The Panel wished to make it clear that [the requirement to use "reasonably available" alternatives] does not mean that a contracting party could be asked to change its substantive patent law or its desired level of enforcement of that law, provided that such law and such level of enforcement are the same for imported and domestically-produced products.").

alternative measure that would involve the continuation of the very risk a Member seeks to avoid is not "reasonably available";[17] whether another Member would desire a different level of protection is irrelevant.

III. HONDURAS MISCHARACTERIZES THE STANDARD FOR FINDING "TREATMENT NO LESS FAVOURABLE" IN ARTICLE III:4 OF THE GATT 1994

10. As mentioned earlier, the United States takes no view as to whether the Bond Requirement (the measure at issue in Honduras' appeal) accords "less favourable treatment" to imports under Article III:4 of the GATT 1994. However, we would like to make several observations. First, the United States notes that it agrees with Honduras that "consistency of a challenged measure" should not "depend on the market's reaction to it, and consequently on factors that normally escape the control of WTO Members rather than the features of the measure itself."[18] In this respect, the Panel correctly set forth the factors for consideration in an Article III:4 analysis that have been used by previous panels and the Appellate Body. As the Panel properly recognized,[19] whether or not imported products receive "less favourable treatment" depends on whether a measure "modifies the conditions of competition" to the detriment of imports.[20]

11. Honduras argues that the Panel erred when it "examined the *current costs paid by one specific importer* in the light of its volumes of imports for 2001-2003 in order to determine the consistency of the bond requirement with Article III:4.[21] It adds that the Panel then rejected its Article III:4 claim on the sole basis of "the diminishing fixed unit costs for importers from 2000 to 2003 . . ."[22] Rather, Honduras argues, the Panel should have:

> . . . compared the fixed per-unit costs of complying with the bond for importers as compared with domestic producers. The Panel . . . erred in finding that a

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[17] *See EC – Asbestos*, Appellate Body Report, para. 174.

[18] Other Appellant's Submission of Honduras, para. 34.

[19] *See* Panel Report, paras. 7.300-7.301 and 7.309.

[20] *Korea – Various Measures on Beef*, Appellate Body Report, para. 137; *see also United States – Section 337,* GATT Panel Report, para. 5.11.

[21] Other Appellant's Submission of Honduras, para. 33 [emphasis in original].

[22] *Id.*, para. 42.

> difference in costs for importers of posting the bond does not create treatment less favourable for imported products as long as the conditions of competition were not adversely affected.[23]

12. The Panel, however, did not do what Honduras claims it did. It is true that the Panel acknowledged the fact that, because the amount of the bond is fixed and domestic producers have higher market shares than importers, the per-unit cost of the bond is higher for importers.[24] It is also true that the Panel described how increases in imports for a Honduran importer have, in recent years, caused the per-unit cost of the bond for that importer to fall.[25] But the Panel neither stated nor suggested that such facts were the basis for its finding that the Bond Requirement did not accord imported products "less favourable treatment". On the contrary, the Panel stated that, without a showing that they had modified the conditions of competition, such differences in the per-unit costs of the bond were in themselves insufficient to demonstrate that importers received "less favourable treatment". It then found that Honduras had not made such a showing. The Panel stated specifically:

> By definition, any expense that is fixed (i.e. not related to volumes of production) may lead to different costs per unit among supplier firms. As long as the difference in costs does not alter the conditions of competition in the relevant market to the detriment of imported products, that fact in itself should not be enough to conclude that the expense creates a less favourable treatment for imported products. . .. In light of the preceding arguments, the Panel considers that Honduras has not presented evidence to support its argument that the different cost per unit generated by complying with the bond requirement has a detrimental impact on the competitive conditions for imported products in relation to domestic products in the Dominican Republic cigarette market.[26]

13. In addition, throughout its appeal Honduras alleges that the Panel improperly applied Article III:4 because it "took into account the market performance of importers in the past years as the decisive element, rather than the bond requirement itself."[27] Honduras cites *Korea – Various Measures on Beef* for the proposition that only *government action* that modifies the

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[23] *Id.*, para. 4.

[24] *See* Panel Report, para. 7.295.

[25] *See id.*, para. 7.299.

[26] *Id.*, paras. 7.300-7.301.

[27] Other Appellant's Submission of Honduras, para. 30.

conditions of competition can give rise to "less favourable treatment".[28] The United States agrees that the business decisions of private economic actors provide no basis, in themselves, for a finding of "less favourable treatment". Yet while Honduras criticizes the Panel for examining the "market performance of importers", it is Honduras, not the Panel, that seeks a finding of "less favourable treatment" on this basis.

14. Indeed, the essence of Honduras' appeal is that the Panel examined the per-unit costs of the bond for *only* a single importer. Instead, as noted above, Honduras claims that the Panel should have compared the per-unit costs of both importers and domestic producers. Yet to do so would necessarily also involve the examination of the "market performance of importers", the very mistake Honduras claimed the Panel made.

15. Finally, we note that the Panel correctly recognized the Appellate Body's view that Article III:4 does not require identical treatment of imported and domestic products, as long as the treatment accorded imported products is no less favorable than that accorded domestic products.[29] In other words, as the United States noted in its oral statement before the Panel, "like imported and domestic products may be treated differently so long as the different treatment does not result in less favorable treatment for imported products."[30]

IV. CONCLUSION

16. The United States thanks the Appellate Body for providing an opportunity to comment on the issues in this proceeding.

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[28] *See id.*, para. 38, *citing Korea – Various Measures on Beef*, Appellate Body Report, para. 149.

[29] *See* Panel Report, para. 7.182; *see also Korea – Various Measures on Beef*, Appellate Body Report, paras. 135-138. The Appellate Body stated that "the Panel erred in its general interpretation that '[a]ny regulatory distinction that is based exclusively on criteria relating to the nationality or the origin of the products is incompatible with Article III.'" *Korea – Various Measures on Beef*, Appellate Body Report, para. 138, *citing Korea – Various Measures on Beef*, Panel Report, para. 627; *see also Canada – Wheat*, Panel Report, para. 6.209; *United States – Section 337*, GATT Panel Report, para. 5.11.

[30] *See* Oral Statement of the United States, 12 May 2004, para. 9.