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CHAPTER IX

DISPUTE RESOLUTION AND ENFORCEMENT

The international legal basis for dispute settlement in the trade area is contained in Articles XXII and XXIII of the GATT, as supplemented over the years by several negotiating round side agreements, and eventually by the Dispute Settlement Understanding, Annex 2 of the WTO Charter. Under the GATT provisions, consultation and ad hoc agreement (as reflected in Article XXII) are the preferred solution to any trade dispute. When that is not possible, the "CONTRACTING PARTIES"–now the Dispute Settlement Body (DSB)–can, under Article XXIII, authorize an offended WTO member to retaliate against another member's failure to honor the GATT by withdrawing or suspending concessions. Usually, a panel is appointed to help resolve the dispute and, if necessary, to prepare it for the DSB. In addition, the CONTRACTING PARTIES can, under Article XXV, waive the application of GATT rules in a particular case.[1] This process has become much more formalized under the DSU.

The corresponding U.S. domestic law is §§ 301-310 of the 1974 Act (generically referred to as "§ 301"), as updated and modified from time to time. Section 301 includes procedures by which a U.S. exporter that believes itself harmed by a foreign nation's trade action can compel the United States Trade Representative (USTR) to consider the issue and, if appropriate, to proceed through the relevant international dispute settlement process. The section also authorizes the president to take such responsive action as may be appropriate, including the imposition of retaliatory duties.[2]

In the very early period of the GATT, the formal dispute settlement processes were taken quite seriously. Later on, however, as might be anticipated, the preference for compromise and political solution–as well as, in some cases, for just ignoring the GATT–became much stronger. Thus, the general trend was a drift from legal decision-making to ad hoc political settlement. However, there were several variations on this theme. During the early 1970s, the United States initiated a number of "cases" against foreign governments, probably in an effort to persuade Congress that further trade negotiations should be authorized to improve the system. Furthermore, the politics of passing the 1979 Act suggested a new effort at making a more regulatory or "legalistic" approach work, but this was an approach stretched by over-enthusiasm, given the protectionist sentiment of the early 1980s. Nevertheless, the idea of refashioning dispute resolution into a more explicitly law-oriented process took hold in the Uruguay Round, and the result was the DSU, which grafts a formal structure onto the relatively fluid

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1. For general discussions on GATT decision-making, see Hudec, *GATT Dispute Settlement after the Tokyo Round: An Unfinished Business*, 13 CORNELL INTL. L.J. 145 (1980)

2. *See* Fisher and Steinhardt, *The Enforcement by Private Citizens of United States Rights Under International Trade Agreements* in P. MACRORY & P. SUCHMAN (eds.), CURRENT LEGAL ASPECTS OF INTERNATIONAL TRADE LAW (1982).

provisions of Articles XXII and XXIII of the GATT.

A. THE DESIGNED FRAMEWORK

1. The Article XXIII Nullification or Impairment Procedure

The original GATT framework appeared to be relatively legalistic, and the standard dispute settlement and enforcement pattern was to be that of Article XXIII–a procedure by which a nation aggrieved by another's violation of the GATT would be able to bring a complaint, and, if successful, obtain international authorization to restrict the offender's exports to the injured nation. The procedure as originally conceived is exemplified in the following sequence, one of the very first examples of GATT dispute settlement.

GATT, UNITED STATES IMPORT RESTRICTIONS ON DAIRY PRODUCTS

41 GATT, BISD, 1st Supp. 31 (1952)

The Contracting Parties

Note with regret from the reports submitted to the Seventh Session that the United States Government has not succeeded in its efforts to effect the repeal of Section 104 of the United States Defense Production Act,

Note that, as a result of amendments made to that Act, and also of consequent administrative action, it has been possible for the United States Government to mitigate for some products the restrictions imposed in accordance with Section 104 of that Act,

Note however that Section 104 in its present form still requires the maintenance of restrictions inconsistent with the provisions of the General Agreement,

Recognise that, although the measures introduced by the United States Government have reduced or eliminated the damage caused to some contracting parties by these restrictions, many contracting parties have indicated that they are still suffering serious damage and that some contracting parties have indicated further that the recent partial relaxation of the restrictions has not improved the position with regard to products in which they are interested,

Confirm the findings made in their resolution of 26 October 1951,

(a) that concessions granted by the United States Government to contracting parties under the General Agreement have been nullified or impaired with[in] the meaning of Article XXIII of the General Agreement and that the import restrictions in question constitute an infringement of Article XI of the agreement and

(b) that the circumstances are serious enough to justify recourse to Article XXIII, paragraph 2, by the contracting parties affected, and

Resolve, notwithstanding any recourse that contracting parties may take to Article XXIII while these restrictions are in effect,

1. to recommend that the United States Government have regard to the effects of its continued application of these restrictive measures in breach of the General Agreement and continue its efforts to secure the repeal of Section 104 of the Defense Production Act as the only satisfactory solution of this problem, and

2. to request the United States Government to report to the Contracting Parties at as early a date as possible and in any case not later than the opening of the Eighth Session of the Contracting Parties on the action which it has taken.

GATT, NETHERLANDS ACTION UNDER ARTICLE XXIII:2 TO SUSPEND OBLIGATIONS TO THE UNITED STATES

GATT, BISD, 1st Supp. 62 (1952)

1. At the Sixth Session the Contracting Parties decided that the import restrictions on dairy products maintained by the United States under Section 104 of the Defense Production Act were contrary to the provisions of the General Agreement and, under the circumstances, were sufficiently serious to justify recourse to paragraph 2 of Article XXIII, by the contracting parties affected. That paragraph provides in part that, if the Contracting Parties consider that the circumstances are serious enough to justify such action, they may authorise a contracting party or parties to suspend the application to any other contracting party or parties of such obligations or concessions under the Agreement as the Contracting Parties determine to be appropriate in the circumstances. Therefore, the Netherlands delegation requested the Contracting Parties, in accordance with Article XXIII: 2, to authorise the Netherlands to suspend the application to the United States of its obligations under the Agreement to the extent necessary to allow the Netherlands to impose an upper limit of 57,000 metric tons on imports of wheat flour from the United States during the calendar year 1953. This would constitute an annual reduc tion of approximately 15,000 metric tons from the rate of current imports from the United States.

2. The Working Party was instructed by the Contracting Parties to investigate the appropriateness of the measure which the Netherlands Government proposed to take, having regard to its equivalence to the impairment suffered by the Netherlands as a result of the United States restrictions.

3. The Working Party felt that the appropriateness of the measure envisaged by the Netherlands Government should be considered from two points of view: in the first place whether, in the circumstances, the measure proposed was appropriate in character, and secondly, whether the extent of the quantitative restriction proposed by the Netherlands Government was reasonable, having regard to the impairment suffered.

4. Although the Working Party recognised that it was appropriate to consider calculations of the trade affected by the measures and countermeasures in question, it was aware that a purely statistical test would not, by itself, be sufficient and that it would also be necessary to consider the broader economic elements entering into the assessment of the impairment suffered. It was agreed therefore that it would be proper to take into account the contention of the Netherlands Government that the restrictions imposed by the United States had had serious effects on the efforts which were being made by the Netherlands to stimulate its exports to the United States not only of the products subject to the restrictions but of other products as well, and the further contention of the Netherlands Government that the restrictions had affected its efforts to overcome balance-of-payments difficulties with which the country was confronted.

5. The meetings of the Working Party were conducted in a spirit of cooperation. The representatives of the Netherlands and the United States presented statements, including

statistical information, for the guidance of the Working Party.

6. The Working Party recognised the difficulties inherent in fixing, with any real precision, the point at which any proposed measure could no longer be considered reasonable. The Working Party was of the view that the size of the measure proposed could not be regarded as unreasonable. However, on the basis of its independent review of the circumstances and of the considerations adduced at this Session, the Working Party decided to recommend a measure somewhat different in magnitude from that proposed by the Netherlands. . .

GATT, NETHERLANDS MEASURES OF SUSPENSION OF OBLIGATIONS TO THE UNITED STATES

GATT, BISD, 1st Supp. 32 (1952)

Taking Note of the request from the Netherlands Government for the application of paragraph 2 of Article XXIII of the General Agreement, and

Considering information relating to the damage suffered by the Netherlands through limitations on its ability to sell its products in the United States market owing to the restrictions imposed by the United States of America under Section 104 of the Defense Production Act,

THE CONTRACTING PARTIES

Determine

1. that the measure proposed by the Netherlands Government is appropriate in character, and

2. that, having regard to

(i) the value of the trade involved,

(ii) the broader elements in the impairment suffered by the Netherlands, and

(iii) the statement of the Netherlands Government that its principal objective in proposing the measure in question is to contribute to the eventual solution of the matter in accordance with the objectives and spirit of the General Agreement, the limitation by the Netherlands of imports of wheat flour from the United States to 60,000 tons in 1953 would be appropriate within the meaning of Article XXIII, and

Authorise the Netherlands Government to suspend the application to the United States of their obligations under the General Agreement to the extent necessary to allow the Netherlands Government to impose an upper limit of 60,000 metric tons on imports of wheat flour from the United States during the calendar year 1953.

QUESTIONS

1. How effective is a sanction such as that the Netherlands imposed against the United States? What are its costs? What if the situation had been reversed, and there had been a U.S. sanction against the Netherlands?

2. What guidelines might you suggest for the relationship between the retaliatory tariff and the underlying GATT violation?

3. What alternative sanctions can you imagine? Fines? Damage actions by offended industries (rather than governments) against the offending foreign government? What are the pros and cons of such alternatives?

4. It is generally assumed that political feasibility requires that these sanctions be kept under executive governmental control, rather than judicial or international control. Is this assumption correct or not? Why?

2. The Article XXV Waiver Procedure

In some cases, a nation that expected to violate the GATT would use a different procedure–a request for a waiver under Article XXV. One of the most important such waivers was also one of the earliest, that granted to the United States, arising from U.S. agricultural legislation that violated the GATT, but which the United States believed to be compelled by domestic politics. The waiver decision, which follows, called for annual reports until the offending import restrictions could be eliminated. GATT discussion of one such report follows the document granting the waiver.

GATT, WAIVER GRANTED TO THE UNITED STATES IN CONNECTION WITH IMPORT RESTRICTIONS IMPOSED UNDER SECTION 22 OF THE UNITED STATES AGRICULTURAL ADJUSTMENT ACT (OF 1933), AS AMENDED

GATT, BISD, 3d Supp. 32 (1955)

Having received the request of the United States Government for a waiver of the provisions of Article II and Article XI of the General Agreement with respect to certain actions by the United States Government required by the provisions of Section 22 of the United States Agricultural Adjustment Act (of 1933), as amended, (hereinafter referred to as Section 22) which are not authorized by the Agreement,

Having also received the statement of the United States:

(a) that there exist in the United States governmental agricultural programmes (including programmes or operations which provide price assistance for certain domestic agricultural products and which operate to limit the production or market supply, or to regulate or control the quality or prices of domestic agricultural products) which from time to time result in domestic prices being maintained at a level in excess of the prices at which imports of the like products can be made available for consumption in the United States and that under such conditions imports may be attracted into the United States in abnormally large quantities or in such manner as to have adverse effects on such programmes or operations unless the inflow of such imports is regulated in some manner;

(b) that the Congress of the United States therefore enacted Section 22 which requires that restrictions in the form either of fees or of quantitative limitations must be imposed on imports whenever the President of the United States finds, after investigation, that such products are being or are practically certain to be imported in such quantities and under such conditions as to render ineffective or materially interfere with any programme or operation undertaken by the United States Department of Agriculture or any agency under its direction with respect to any agricultural commodity or product thereof, or to reduce substantially the amount of any product processed in the United States from any agricultural commodity or product thereof, with respect to which such

a programme is being undertaken, and has required the President not to accept any international obligation which would be inconsistent with the requirements of the Section;

Noting:

(a) that, to help solve the problem of surpluses of products for which Section 22 import quotas are now in effect, the United States Government has taken positive steps aimed at reducing 1955 crop supplies by lowering support price levels or by imposing marketing quotas at minimum levels permitted by legislation; and that it is the intention of the United States Government to continue to seek a solution of the problem of surpluses of agricultural commodities;

(b) the assurance of the United States Government that it will discuss proposals under Section 22 with all countries having a substantial interest prior to taking action, and will give prompt consideration to any representations made to it;

(c) that it is the intention of the United States Government promptly to terminate any restrictions imposed when it finds that circumstances requiring the action no longer exist, and to modify restrictions whenever changed circumstances warrant such modification;

THE CONTRACTING PARTIES

Decide, pursuant to paragraph 5 (a) of Article XXV of the General Agreement and in consideration of the assurances recorded above, that subject to the conditions and procedures set out hereunder the obligations of the United States under the provisions of Articles II and XI of the General Agreement are waived to the extent necessary to prevent a conflict with such provisions of the General Agreement in the case of action required to be taken by the Government of the United States under Section 22.

Declare that this Decision shall not preclude the right of affected contracting parties to have recourse to the appropriate provisions of Article XXIII, and

Declare, further, that in deciding as aforesaid, they regret that circumstances make it necessary for the United States to continue to apply import restrictions which, in certain cases, adversely affect the trade of a number of contracting parties, impair concessions granted by the United States and thus impede the attainment of the objectives of the General Agreement.

CONDITIONS AND PROCEDURES

1. Upon request of any contracting party which considers that its interests are seriously prejudiced by reason of any import restriction imposed under Section 22, whether or not covered by this Decision, the United States will promptly undertake a review to determine whether there has been a change in circumstances which would require such restrictions to be modified or terminated. In the event the review shows such a change, the United States will institute an investigation in the manner provided by Section 22.

2. Should the President of the United States acting in pursuance of Section 22 cause an investigation to be made to determine whether any existing import restriction should be modified, terminated or extended, or whether restrictions should be imposed on the import of any additional product, the United States will notify the Contracting Parties and, in accordance with Article XXII of the General Agreement, accord to any contracting party which considers that its interests would be prejudiced the fullest notice and opportunity, consistent with the legislative requirements of the United States, for representations and consultation.

3. The United States will give due consideration to any representations submitted to it including:

(a) When investigating whether any existing import restriction should be modified, terminated or extended, representations that a greater volume of imports than is permitted under the import restriction would not have the effects required to be corrected by Section 22, including representations that the volume of imports that would have entered in the absence of governmental agricultural programmes would not have such effects;

(b) When investigating with respect to import restrictions on additional products, representations with regard to:

(i) the effects of imports of any product upon any programme or operation undertaken by the United States Department of Agriculture or any agency under its direction, or upon the domestic production of any agricultural commodity or product thereof for which such a programme or operation is undertaken, including representations that the volume of imports which would have entered in the absence of governmental agricultural programmes will not have the effects required to be corrected by Section 22;

(ii) the representative period to be used for the determination of any quota;

(c) Representations by any contracting party that the portion of a total quota allotted or proposed to be allotted to it is inequitable because of circumstances that operated to reduce imports from that contracting party of the product concerned during the past representative period on which such import quota is based.

4. As soon as the President has made his decision following any investigation the United States will notify the Contracting Parties and those contracting parties which have made representations or entered into consultations. If the Decision imposes restrictions on additional products or extends or intensifies existing restrictions the notification by the United States will include particulars of such restrictions and the reasons for them (regardless of whether the restriction is consistent with the General Agreement). At the time of such notification the provisions of the General Agreement are waived to the extent necessary to permit such restrictions to be applied under the General Agreement, subject to the review herein provided and, as declared above, without prejudice to the right of the affected contracting parties to have recourse to the appropriate provisions of Article XXIII.

5. The United States will remove or relax each restriction permitted under this waiver as soon as it finds that the circumstances requiring such restriction no longer exist or have changed so as no longer to require its imposition in its existing form.

6. The Contracting Parties will make an annual review of any action taken by the United States under this Decision. For each such review the United States will furnish a report to the Contracting Parties showing any modification or removal of restrictions effected since the previous report, the restrictions in effect under Section 22 and the reasons why such restrictions (regardless of whether covered by this waiver) continue to be applied and any steps it has taken with a view to a solution of the problem of surpluses of agricultural commodities.

GATT, UNITED STATES IMPORT RESTRICTIONS ON AGRICULTURAL PRODUCTS

GATT, BISD, 27th Supp. 206 (1980)

1. The Working Party on United States Import Restrictions Waiver was established by the Council on 26 March 1980 with the following terms of reference:

To examine the twenty-second annual report (L/4925) submitted by the Government of the United States under the Decision of 5 March 1955, and to report to the Council.

2. The Working Party met on 28 May and on 23 June 1980 under the Chairmanship of Mr. C. Magnus P. Lemmel (Sweden).

3. In accordance with its terms of reference, the Working Party has examined the twenty-second annual report submitted by the Government of the United States under the Decision of 5 March 1955, on import restrictions in effect under Section 22 of the United States Agricultural Adjustment Act as amended, on the reasons for the maintenance of these restrictions, and on the steps taken with a view to a solution of the problem of agricultural surpluses. On the basis of the report and with the assistance of the representative of the United States, the Working Party has reviewed the action taken by the United States Government under the Decision.

4. The representative of the United States, introducing the report submitted by his Government, said that, since its enactment, Section 22 had been used sparingly and only as absolutely necessary. He recalled that the utilization of Section 22 powers to establish quotas or import fees was confined exclusively to commodities which were subject to support programs and that import restriction under Section 22 currently in force applied to four groups of commodities: cotton and cotton waste, peanuts, sugar, and dairy products. Summarizing recent developments with respect to the commodity programs and imports controls concerned, he noted that on 31 March 1980, a special temporary import quota had been imposed on upland cotton in addition to the existing quota established under Section 22 authority.

5. With reference to dairy products, the representative of the United States went on to say that important changes had taken place since the last annual report as a consequence of the agreements reached in the MTN. He recalled that his Government had made important concessions in the framework of the MTN with respect to import quotas for certain cheeses and chocolate crumb and to the system of their administration. He stressed that the implementation by the United States of its MTN agreements on dairy products was taking place during a period of particular difficulties, both economically and politically.

6. The representative of the United States furthermore said that his Government had attempted to administer the import restrictions imposed under Section 22 in a fair and open manner and to carry out responsibly its obligations under the waiver. He stated that the United States was prepared to consult with its GATT partners on any problems which might arise. Further, the United States keeps the situation under continuing review and will carefully examine whether the present arrangement should be changed. He noted that the basic United States farm legislation which authorizes and directs the Government to carry out the support programs for the commodities concerned was subject to renewal next year. He was ready to note and convey to his authorities any comments the Working Party would wish to make and was ready to answer any questions.

7. The Working Party was grateful for the introductory comments given by the representative of the United States. Several members, however, expressed concern with the maintenance of this waiver and with the fact that alternative policies had not been pursued. They felt that the annual report did not entirely fulfil the obligations taken by the United States under the Contracting Parties' Decision of 5 March 1955, and in particular those set out in condition 6 of that Decision.

8. A member of the Working Party pointed out that if the problem of surpluses of

certain agricultural commodities was a structural one, then the recourse to temporary measures could not result in a positive solution, while, if the problem was one of a conjunctural nature, the measures already taken over twenty-five years had to be regarded as not effective. In both cases, in his view, the waiver was not justified.

9. With reference to the operation of the restriction under the waiver, a further member noted with satisfaction that the list of products subject to import restriction had now been shortened as to cover four commodity groups. He expressed, however, deep concern over the existing restrictions and over the fact that those temporarily suspended could presumably be reinstated. In his view, more information was needed on the coverage of products which were subjected to action under Section 22, on the terms of suspension for the products which were previously subject to restrictions, and on legal possibilities to remove on a permanent basis those restrictions which were temporarily suspended.

10. A member of the Working Party recalled that during the recently concluded MTN, the United States was prepared to negotiate a dismantling of Section 22 quotas against commitments by other countries to pursue policies aimed at eliminating unfair export practices, and, in particular, export subsidization. He argued that, in his view, that constituted a recognition by the United States that the circumstances under which the waiver was granted had changed, the actual problem not being one of agricultural surpluses but of subsidized exports. He pointed out that a "change in circumstances" was the basis on which the United States in 1955 undertook to terminate or modify its Section 22 quotas, and that, with regard to subsidized exports, the United States has the same protection from such practices as other contracting parties, namely recourse to the provisions of the General Agreement. Additional protection was available to the United States in the form of the Code on Subsidies and Countervailing Duties and in its own domestic legislation.

11. Several members of the Working Party stated that the Government of the United States in its annual report should have paid more attention to changes in those circumstances which had led the Contracting Parties to grant the waiver in 1955. They also suggested, as they had in the past, that the United States Government should consider alternative measures, including adjustment measures, for stabilizing the domestic markets without recourse to quota restrictions on imports.

12. In its examination of the report, the Working Party devoted special attention to the section dealing with dairy products. In this connexion, several members of the Working Party felt that the United States had particularly failed to make progress for this group of commodities in terms of the obligations it accepted when the waiver was granted.

13. A member of the Working Party stated that, in his opinion, a review of the events of the last twenty-five years showed that, at least in the field of dairy products, the United States had pursued a policy not envisaged by the Contracting Parties when the waiver was granted. He said that, by maintaining dairy support prices at levels too high in relation to its obligations under the waiver, the United States had indeed pursued a long-term policy of self-sufficiency in the dairy sector–an option that was not envisaged by the Contracting Parties when they had granted the waiver. In his view, even within existing legislative provisions, the United States could have done much more to hold the rate of increase of dairy support prices to a level that would have reduced dairy surpluses and permitted greater access for imports. He noted that the dairy trade was of crucial importance to the economy of his country. He stated that after twenty-five years the circumstances that existed when the waiver was granted have substantially changed.

Commenting in particular on certain economic features of and developments in the United States dairy industry, he stressed that the report failed to address these changes and the effect that those could have had in supporting some modification or termination of import restrictions. He recalled that at the time the waiver was granted there had been discussion of the use of basic measures, in the context of the search for solutions to the problem of continuing surpluses. He thought that these should be tried again. He noted that other reports by United States Government agencies recognized the possibility for real alternatives to the present severe restrictions on dairy imports and the need to undertake studies in this respect and urged that these be presented. He pointed out that despite continuing increases in consumption of cheese, controls on this product had been tightened. He stated that the annual report also failed to provide an indication as to the future intentions of the United States with respect to complying with the obligations of the waiver, and he requested the representative of the United States to provide such information.

15. With respect to the quota on cheese applied since 1955 by the United States under the provisions of the waiver, a member asked whether in the light of the significant development which had occurred over this period in the export capacity of the milk industry of some countries and of important changes in trade policy relations between certain countries, the United States had a position on the question of the situation of eventual new suppliers, and how the United States intended to treat these suppliers within its cheese quota. Referring more specifically to the case of his country he said that his country, which had a substantial interest in supplying cheese to the US market, was not included in the United States import quota on cheese and that it would like to get an equitable share within this quota. He added that the past performance of his country did not adequately reflect its supplying interests but this was due to special factors as the existence of the quota in which his country had not had a share and the lack of m.f.n. treatment between the United States and his country until 1978. . . .

18. Recalling that casein was currently the subject of a Section 332 enquiry in the United States under the United States Trade Act of 1974, a member of the Working Party asked the United States representative for an indication of the current status of that enquiry. He added that the basic argument used by those favouring import restrictions on casein–that it competes with domestic sales of skimmed milk powder [SMP]–was spurious, competition to SMP sales in the United States coming from increasing United States production of whey powder.

19. Replying to the various points made, the representative of the United States stated that although twenty-five years had elapsed and certain changes had occurred, the underlying problems which had pressed the United States to request a waiver in 1955 still remained. He stressed, however, that the United States had always met its obligations, fulfilled its requirements, and submitted reports as stipulated under the waiver. In reply to the question whether different treatments were applied in the United States to substitutes for dairy products, he said that both animal and vegetable fats were subject to the same requirements in the domestic market. In response to the question concerning a possible introduction of quantitative restrictions on casein under Section 22, the representative of the United States indicated that a recent investigation by the International Trade Commission had concluded that no ground existed at present for introducing such restrictions. Under current legislation, the dairy import quotas may not be expanded except through regular Section 22 procedures initiated by a recommendation by the Secretary of Agriculture to the President that increased imports will not materially interfere with the domestic price support program for milk. With net removals

by the Commodity Credit Corporation [CCC] for this marketing year expected to total seven billion pounds, milk equivalent, at a cost to the Government of approximately $1 billion, no such recommendation is possible. Total cost of CCC Dairy program purchases for the 1978-79 fiscal year was $246.7 million. Estimated cost for the present fiscal year ending 30 September 1980 is $1,001.7 million. Special programs for increasing dairy products consumption aim at bringing supply and demand more nearly into balance. Such programs currently in operation include (a) addition of mozzarella cheese to items provided by CCC to the school lunch program; (b) expansion of the food stamp program; (c) increased participation in the women-infants-children (WIC) program, which provides financial assistance to certain disadvantaged groups for increased food purchases, including dairy products; (d) the bonus program, under which certain community welfare programs may obtain extra supplies of certain foods, including dairy products, free of charge after satisfying specified basic procurement requirements; and (e) increased distribution on Indian reservations.

20. Noting that most of the discussion had focussed on dairy products, the representative of the United States pointed out that other countries maintained restrictions on this group of commodities and that most of these restrictions were not even being discussed and consulted upon in the GATT.

21. Referring to a point made by a member of the Working Party, he recalled that the United States had been prepared to negotiate its dairy restrictions in the course of the MTN with a view to finding a global solution to the problems of the dairy sector. It was for that reason that the United States had joined the International Dairy Arrangement.

27. The Working Party noted the various statements made by the representative of the United States. Several members felt, however, that the information contained in the report was not complete and that in its present form it could not provide any longer a basis for a full examination as envisaged under the waiver.

28. Referring to dairy products in particular, some members of the Working Party recalled the importance their governments attached to a satisfactory resolution and termination of the restrictions under the waiver. They stated that the United States should undertake a fundamental reassessment of its dairy import policy, including the levels of permitted dairy imports. The careful reappraisal should be made against the terms and conditions of the waiver granted in 1955. The results of the reappraisal should be included in the next annual report submitted to the Contracting Parties. They expressed the view that the United States should provide a detailed assessment of how it had performed in the dairy sector in relation to the terms of the waiver. Further, the United States should give particular attention to why they had so far not been able to liberalize, let alone dismantle, the import restrictions maintained under the waiver. The possibility of using alternative measures should also be addressed. They requested information on initiatives which the United States intends to take in order to prevent or moderate production of dairy surpluses in the future and to encourage greater domestic offtake of dairy products. They also requested a clear indication on behalf of the United States, to be included in its next report, about when and how the United States authorities envisaged to terminate the restrictions under the waiver, particularly on dairy products.

31. The Working Party noted that the representative of the United States stated that his country had both lived up to the commitments of the waiver and had fulfilled its requirements faithfully. In his view, the use of import restrictions on agricultural products should be regarded as a global problem, one that the United States could not be expected to try to solve alone. In that spirit, in its next annual report, he expressed the

willingness of his authorities to endeavour to provide such further information requested by members of the Working Party. He further stated he would report fully to his authorities the result of the Working Party and transmit all suggestions, comments and questions which had been made. He expressed his thanks to the members of the Working Party for the constructive spirit which had prevailed during the course of the meeting.

32. Members of the Working Party expressed their gratitude to the representative of the United States for his co-operative attitude and the frank way in which he had taken part in the discussion.

NOTES AND QUESTIONS

1. From the viewpoint of the future of the GATT, was it wise for the United States to seek such a waiver in 1955 when it had the strongest economy in the world? Was it politically unavoidable, given relations with Congress and the problematic constitutional status of the GATT?

2. What is the proper role of such a waiver provision? If you were advising a government as to its vote on another nation's request for a waiver, what principles would you use?

3. What is the point of still discussing an annual report, 25 years later? In thinking about this question, consider the different kinds of issues posed in paragraphs 15, 18, 19, 20, and 21.

4. In comparing the formal and real effects of the waiver procedure with those of Article XXIII, what differences do you see? When is it better to use one rather than the other?

5. Note that there are other, specialized institutions and procedures for certain types of international commercial disputes. For example, the International Centre for the Settlement of Investment Disputes (ICSID), the Multilateral Investment Guarantee Agency (MIGA), and the Overseas Private Investment Corporation (OPIC)–as well as bilateral investment treaties (BITs) between the United States and many of its trading partners–offer dispute settlement options for investment disputes covered by each of those arrangements. ICSID, an affiliate or subordinate organ of the International Bank for Reconstruction and Development (World Bank), facilitates the establishment of conciliation commissions and arbitration tribunals, and with the administration of their proceedings, in specified disputes between foreign investors and states signatory to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States.[3] MIGA, another World Bank affiliate, provides political risk insurance to qualifying foreign investments in any MIGA-member state that has assented to the agency's operation within its jurisdiction.[4] OPIC, a U.S. agency, is essentially involved in investment insurance as well.[5] BITs incorporate international law standards to apply to investment disputes between nationals of each signatory against the other signatory. A BIT will also specify the procedural or institutional devices to be used in resolving

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3. For an introduction to ICSID, see Andrés Rigo Sureda, *ICSID: An Overview*, 13 World Arb. & Mediation Rep. 166 (2002).

4. For a very general discussion of MIGA and its functions, see Daniel D. Bradlow, *Should the International Financial Institutions Play a Role in the Implementation and Enforcement of International Humanitarian Law?*, 50 U. Kan. L. Rev. 695 (2002). On U.S. participation in MIGA, see Multilateral Investment Guarantee Agency Act, 22 U.S.C. §290k-2.

5. 22 U.S.C. §§ 2191-2200.

disputes.

B. CONTEMPORARY PRACTICE–WTO

In this section, we begin with an overview of the Dispute Settlement Understanding (DSU), the formal basis for dispute settlement and enforcement under the WTO.[1] Thereafter we present two examples–one concerning New Zealand and U.S. complaints about Canadian dairy subsidies, the other concerning an EU complaint about the U.S. tax treatment of foreign source income–that show the system at work today.

1. The Dispute Settlement Understanding: An Overview

Settlement of disputes between WTO members involving the WTO Agreement and its annexes is the responsibility of the Dispute Settlement Body (DSB), an organ of the WTO with the same participants as the General Council. DSU art. 2.1. The dispute resolution process begins with mandatory consultations between the parties to the dispute. *Id*. art. 4. *See also* GATT art. XXII. The claimant member requests consultations of an alleged respondent state, with a view to reaching settlement of the dispute directly. DSU art. 4.3. If the respondent refuses consultations, or if the consultations fail to resolve the dispute, the claimant may request that a panel be established by the DSB to resolve the dispute. *Id*. arts. 4.3, 4.7, 6.1. The Secretariat proposes three panelists from a list of candidates that it maintains. *Id*. art. 8.4-8.7.[1] Panelists may be government officials, private citizens, former WTO representatives or Secretariat employees. *Id*. art. 8.1. Parties may oppose the nominees for unspecified "compelling reasons" only. *Id*. art. 8.6. If the parties do not agree to the nominees within twenty days, the Director-General appoints the panel, after consultation with the Chairs of the DSB and the relevant council or committee. *Id*. art. 8.7.

However selected, the panel serves as the trier of fact and law. *Id*. art. 11. The parties direct submissions to the panel, and the panel may also consider other information as it deems necessary. *Id*. arts. 12, 13. After considering the matter, the panel issues a panel report constituting its decision in the dispute. *Id*. art. 15.3. Before it can be binding, a panel report must be adopted by the DSB itself. *Id*. art. 16. Here there is a sharp contrast with the former GATT practice under GATT art. XXIII. The GATT "CONTRACTING PARTIES" could adopt a panel decision only by *consensus*, which effectively gave any "contracting party"–*e.g.*, the losing party to the dispute–a veto over the final decision. Under the DSU, the DSB is required to adopt a panel report unless there is a consensus *not* to adopt the report. *Id*. art. 16.4. Hence, any member–*e.g.*, the winning party to the dispute–can block this negative consensus. *See id*. art. 2.4, note 1.

Assuming–as one would expect–that the panel report will be adopted, the losing party may either accept the decision, or appeal to the standing Appellate Body. *Id*. art. 17.1. This is the second major change from dispute settlement practice under GATT art. XXIII. The Appellate Body consists of seven persons appointed by the DSB for four-

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1. For background, see *supra* Chapter III at ▬. *See also* Joel P. Trachtman, *The Domain of WTO Dispute Resolution*, 40 Harv. Int'l L.J. 333 (1999); Faryar Shirzad, The WTO Dispute Settlement System: Prospects for Reform, 31 Law & Pol'y Int'l Bus. 769 (2000); Jeffrey Michael Smith, *Three Models of Judicial Institutions in International Organizations: The European Union, the United Nations, and the World Trade Organization*, 10 Tulsa J. Comp. & Int'l L. 115 (2002).

1. Upon the parties' agreement, the panel can consist of five members. DSU art. 8.5.

year terms. DSU art. 17.1, 17.2. No member may be affiliated with any state, and each may be reappointed only once. *Id*. art. 17.2, 17.3. Appellate Body decisions are by three-member appellate panels, sitting in rotation. *Id*. art. 17.1. Review by the appellate panel is limited to issues of law and legal interpretations. *Id*. art. 17.6. In reaching a decision, the panel is guided by the objective of providing "security and predictability." *Id*. art. 3.2.

If a winning claimant is dissatisfied with any steps taken by the respondent to comply with the adopted panel and/or Appellate Body report, it may seek compliance through resort to DSU art. 21. As we shall see in the two examples that follow, this compliance procedure involves establishment of a panel, adoption of the panel report, and possible appeal to the DSB by the losing party, and adoption of a second Appellate Body report–or maybe a third if the dispute persists.

The DSB, the Appellate Body, and the individual panels have been widely used. Figure 9.1, *infra*, summarizes WTO dispute resolution experience. Since its establishment–through mid-January 2003–279 disputes, involving 180 distinct matters, have been brought to the DSB,[2] with some duplication due to the establishment of compliance panels and multiple appeals. The following two examples from DSB jurisprudence should serve to illustrate the complexities of the dispute settlement procedures. They also offer examples of the approaches taken by panels to a broad range of legal issues–both substantive issues concerning the rights of the parties, and typical institutional or judicial questions such as allocation of burdens of proof, relevance of past decisions and other legal authority, and appellate deference to the decisions of the dispute panel.

2. *Reported in* http://www.wto.org/english/tratop_e/dispu_e/distabase_e.htm (visited January 19, 2003).

[Figure 9.1–*in revision*]

2. *Exhibit A: New Zealand, U.S. v. Canada*

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, December 20, 2002

I. Introduction

1. Canada appeals certain issues of law and legal interpretations in the Panel Report, 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 (the "Panel Report"). The Panel was established to consider a complaint by New Zealand and the United States that certain measures taken by Canada to comply with the recommendations and rulings of the Dispute Settlement Body (the "DSB") in Canada - Dairy are not consistent with Canada's obligations under the Agreement on Agriculture and the Agreement on Subsidies and Countervailing Measures (the "SCM Agreement").

2. In Canada - Dairy, the original panel and the Appellate Body found, inter alia, that Canada provided, through Special Milk Classes 5(d) and 5(e), "export subsidies" within the meaning of Article 9.1(c) of the Agreement on Agriculture. The original panel and the Appellate Body also found that Canada provided these export subsidies in excess of the quantity commitment levels specified in its Schedule to the General Agreement on Tariffs and Trade 1994 (the "Schedule") and that, therefore, Canada had acted inconsistently with its obligations under Articles 3.3 and 8 of the Agreement on Agriculture. On 27 October 1999, the DSB adopted the original panel and Appellate Body reports. . . .

4. Canada . . . adopted certain measures with a view to implementing the recommendations and rulings of the DSB. . . . Taking the view that certain of these measures were not consistent with Canada's obligations under the Agreement on Agriculture and the SCM Agreement, New Zealand and the United States requested, on 16 February 2001, that the matter be referred to a panel pursuant to Article 21.5 of the DSU.

5. On the same day, New Zealand and the United States also requested authorization from the DSB to suspend concessions and other obligations, as provided for in Article 22.2 of the DSU. Canada objected to the level of suspension proposed and the matter was referred to arbitration, pursuant to Article 22.6 of the DSU. However, the parties agreed to request the arbitrator to suspend its work pending the outcome of the Article 21.5 proceedings.

6. The panel in Canada - Dairy (Article 21.5 - New Zealand and US) [the "first Article 21.5 panel"] found that Canada provided, through its "commercial export milk" ("CEM") mechanism, "export subsidies" within the meaning of Article 9.1(c) of the Agreement on Agriculture. The panel also found that Canada provided these export subsidies in excess of the quantity commitment levels specified in its Schedule and that,

therefore, Canada had acted inconsistently with its obligations under Articles 3.3 and 8 of the Agreement on Agriculture. The Appellate Body reversed the panel's findings on the grounds that the panel had erred in its interpretation of Article 9.1(c). The Appellate Body held that the appropriate standard, in those proceedings, for determining whether "payments" are made under Article 9.1(c), is not, as held by the first Article 21.5 panel, the domestic price, but rather the producer's costs of production. However, in the light of the factual findings made by the first Article 21.5 panel, the Appellate Body was unable to determine whether the implementation measures involved such "payments" and, hence, export subsidies within the meaning of Article 9.1(c). Consequently, the Appellate Body was also unable to determine whether these measures were consistent with Articles 3.3 and 8 of the Agreement on Agriculture.

7. On 6 December 2001, before adoption of the panel and Appellate Body reports in the first Article 21.5 proceedings,[11] New Zealand and the United States requested the establishment of a second Article 21.5 panel. They maintained that the measures taken by Canada to comply with the recommendations and rulings of the DSB of 27 October 1999, that is, the same measures at issue in the first Article 21.5 proceedings, were inconsistent with Canada's obligations under the Agreement on Agriculture. . . .

9. In the Panel Report, circulated to Members of the World Trade Organization (the "WTO") on 26 July 2002, the Panel concluded that:

> . . . Canada, through the CEM scheme and the continued operation of Special Milk Class 5(d), has acted inconsistently with its obligations under Articles 3.3 and 8 of the Agreement on Agriculture, by providing export subsidies within the meaning of Article 9.1(c) of the Agreement on Agriculture in excess of its quantity commitment levels specified in its Schedule for exports of cheese and "other dairy products". In light of our alternative finding ... that Canada has acted inconsistently with its obligations under Article 10.1 of the Agreement on Agriculture, we conclude that Canada has acted inconsistently with its obligations under Article 8 of the Agreement on Agriculture.

The Panel recommended that the DSB request Canada "to bring its dairy products marketing regime into conformity with its obligations in respect of export subsidies under the Agreement on Agriculture."

10. On 23 September 2002, Canada notified the DSB of its intention to appeal certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel, pursuant to Article 16.4 of the DSU. . . . On 3 October 2002, Canada filed its appellant's submission. On 18 October 2002, New Zealand and the United States each filed an appellee's submission. On the same day, Argentina and the European Communities each filed a third participant's submission. On the same day, Australia notified the Appellate Body Secretariat that, although it would not file a written submission, it intended to participate at the oral hearing. . . .

II. Background

12. The original panel found, inter alia, and the Appellate Body upheld, that Canada provided, through Special Milk Classes 5(d) and 5(e), "export subsidies" within the meaning of Article 9.1(c) of the Agreement on Agriculture. It was also found that these

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11. The DSB adopted the panel report and the Appellate Body Report in Canada - Dairy (Article 21.5 -New Zealand and US) on 18 December 2001.

subsidies were being provided for quantities of exports that exceeded the quantity commitment level specified in Canada's Schedule. The original panel concluded, and the Appellate Body upheld, that Canada, therefore, had acted inconsistently with its obligations under Articles 3.3 and 8 of the Agreement on Agriculture.

13. By way of implementation, Canada abolished Special Milk Class 5(e) and restricted export subsidies under Special Milk Class 5(d) to its commitment levels.[26] At the same time, Canada established a new class of milk, Class 4(m), under which over-quota milk can be sold as domestic animal feed. Canada otherwise left unchanged its domestic milk supply management system, under which domestic milk supply is controlled through the allocation of quota to individual milk producers by government agencies. Generally, a producer can sell milk domestically only within the limits of its quota. The only exception is that a producer can sell over-quota milk in the new Class 4(m) as domestic animal feed, but for a much lower price. Moreover, the price of domestic milk is fixed by government agencies. Government agencies also market domestic milk, collect the sales proceeds and distribute these proceeds among producers.

14. Canada also introduced a new category of milk for export processing, known as "commercial export milk" ("CEM"). Sales of CEM are made by Canadian producers to Canadian processors, for processing of that milk into various dairy products for export. These sales are made pursuant to "pre-commitment" contracts, that is, contracts concluded in advance of milk production. Canadian producers may sell any quantity of CEM to processors on terms and conditions freely negotiated between the producer and the processor. Sales of CEM do not require a quota or any other form of permit from the Canadian government or its agencies. Revenues derived from sales of CEM are collected directly by producers, without government involvement. However, if a dairy product derived from CEM is sold on the domestic market, the processor is liable to financial penalties for diverting the dairy product into the domestic market. . . .

IV. Issues Raised in this Appeal

54. This appeal raises the following issues:

(a) whether the Panel erred . . . in its finding under Article 10.3 of the Agreement on Agriculture, with respect to the allocation of the burden of proof under that provision;

(b) whether the Panel erred . . . in its finding under Article 9.1(c) of the Agreement on Agriculture, in particular, in finding that "commercial export milk" ("CEM") involves "payments" and that these "payments" are "financed by virtue of governmental action"; and

(c) whether the Panel erred . . . in reaching its alternative finding under Article 10.1 of the Agreement on Agriculture, that CEM involves export subsidies applied in a manner that is inconsistent with that provision.

V. Article 10.3 of the Agreement on Agriculture–Rules of Evidence

55. At the outset of its findings, the Panel considered the significance of Article 10.3 of the Agreement on Agriculture for these proceedings. The Panel noted that the parties were in agreement that, under Article 10.3, Canada–the responding Member–bears the burden of proof. Accordingly, the Panel opined that, if the complaining Members

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26. For a more detailed description of the pre-existing milk supply management system see Appellate Body Report, Canada - Dairy, paras. 6-16; and Panel Report, Canada - Dairy, paras. 2.1-2.66

demonstrated "that Canada has exceeded its export subsidy reduction commitment levels on certain dairy products", it would be for Canada to establish that it is not providing export subsidies in relation to the exports exceeding its commitment levels. In that respect, the Panel stated that:

> ... an operational interpretation of Article 10.3 requires that the Complainants make a prima facie showing that the elements of the claimed export subsidies are present.
>
> ... [P]rovided that the Complainants make out a prima facie case that certain elements of the Canadian regulation of its dairy industry constitute export subsidies under either Article 9.1(c) or Article 10.1, it will then be for Canada, pursuant to Article 10.3 of the Agreement on Agriculture ... to establish that [these products] do not benefit from these particular types of export subsidies.

56. Thus, the Panel envisaged a three-step process under Article 10.3:

> (i) The complaining Member(s) must demonstrate that the responding Member has exported an agricultural product in quantities that exceed the quantity commitment level specified in its Schedule to the General Agreement on Tariffs and Trade 1994 (the "Schedule");
>
> (ii) the complaining Member(s) must next "make out" a prima facie case that "the elements of the claimed export subsidies" are present; and
>
> (iii) the responding Member(s) must establish that no export subsidy has been granted for exports of the product in excess of the quantity commitment level.

57. Canada considers that the Panel erred by requiring the complaining Members to make out a prima facie case of their claims. In consequence, Canada argues that the Panel failed properly to apply the burden of proof. Canada asserts that Article 10.3:

> ... sets out a reverse burden of proof, which ... requires the respondent to establish a rebuttable presumption that its measures are not inconsistent. It is then up to the complainant to present evidence and argument that rebuts this presumption.

58. In its appeal, Canada submits that the original panel in Canada - Dairy correctly interpreted Article 10.3.

59. In the original panel proceedings, the panel made the following remarks on Article 10.3:

> This provision shifts the burden of proof from the complainant to the defendant. A defending party (i.e., the exporting country) alleging that exports in excess of its reduction commitment level are not subsidized must demonstrate that no export subsidy in respect of this excess has been granted. All parties in dispute agree that the wording of Article 10.3 has this effect of reversing the usual burden of proof.

60. The original panel did not require the complaining Member to make out a prima facie case; that is, the second step above was not included in the reasoning. Instead, the original panel read Article 10.3 as allocating the burden of proof to the responding Member to demonstrate that no subsidies were provided for exports exceeding the

commitment levels (that is, the third step above).[50]

61. In the first Article 21.5 proceedings, the panel expressed a very similar view, opining that "when reduction commitments have been exceeded, Article 10.3 has the effect of reversing the usual burden of proof ". That panel did not require the complaining Members to make out a prima facie case of the elements of the claimed export subsidy.

62. The meaning of Article 10.3 of the Agreement on Agriculture was also addressed in the original proceedings in US - FSC.[a] In that dispute, the panel considered it "evident" that Article 10.3 "shifts" or, as it also said, "reverses", the usual rule that the burden of proof is on the complaining Member to establish its claims. That panel also made no mention of any requirement for the complaining Member to make out a prima facie case of the elements of the claimed export subsidy.

63. Although Article 10.3 of the Agreement on Agriculture has been examined by several panels, this is the first time that we examine the interpretation of this provision.

64. Before addressing Article 10.3, it is useful to recall our view of the burden of proof as a general matter. This issue was first examined in US - Wool Shirts and Blouses,[b] where we stated that:

> ... various international tribunals, including the International Court of Justice, have generally and consistently accepted and applied the rule that the party who asserts a fact, whether the claimant or the respondent, is responsible for providing proof thereof. Also, it is a generally-accepted canon of evidence in civil law, common law and, in fact, most jurisdictions, that the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence. If that party adduces evidence sufficient to raise a presumption that what is claimed is true, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption. (footnotes omitted)

65. In EC - Hormones,[c] we said:

> The initial burden lies on the complaining party, which must establish a prima facie case of inconsistency with a particular provision of the SPS Agreement on the part of the defending party, or more precisely, of its SPS measure or measures complained about. When that prima facie case is made, the burden of proof moves to the defending party, which must in turn counter or refute the claimed inconsistency.

66. Thus, we have consistently held that, as a general matter, the burden of proof rests upon the complaining Member. That Member must make out a prima facie case by presenting sufficient evidence to raise a presumption in favour of its claim. If the complaining Member succeeds, the responding Member may then seek to rebut this presumption. Therefore, under the usual allocation of the burden of proof, a responding Member's measure will be treated as WTO-consistent, until sufficient evidence is

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50. The original panel also established that Canada had exported dairy products in quantities exceeding the quantity commitment level (that is, the first step above). (Ibid., para. 7.34)

a. Panel Report, *United States–Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/R, adopted 20 March 2000, as modified by the Appellate Body Report, WT/DS108/AB/R, DSR 2000:IV, 1677.

b. Appellate Body Report, *United States–Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R and Corr.1, adopted 23 May 1997, DSR 1997:I, 323.

c. Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:I, 135.

presented to prove the contrary. We will not readily find that the usual rules on burden of proof do not apply, as they reflect a "canon of evidence" accepted and applied in international proceedings. [The report then quoted the language of article 10.3 of the Agreement on Agriculture.]

68. This provision requires that a specific Member, in defined circumstances, "establish that no export subsidy ... has been granted". We begin by identifying the specific Member and circumstances to which Article 10.3 applies. The provision refers to a Member making a "claim" that certain exports are "not [being] subsidized". Although the word "claim" usually refers to an assertion by a complaining Member that a measure is WTO-inconsistent, in this provision the word "claim" refers to an assertion by a responding Member that a measure is WTO-consistent. The "claim" to which Article 10.3 refers is, therefore, a defensive argument made by the responding Member.

69. Article 10.3 does not impose any substantive obligations regulating the grant of export subsidies under the Agreement on Agriculture. Rather, Article 10.3 provides a special rule for proof of export subsidies that applies in certain disputes under Articles 3, 8, 9, and 10 of the Agreement on Agriculture.

70. In identifying the nature of the special rule, it is useful to analyze the character of claims brought under these provisions. Pursuant to Article 3 of the Agreement on Agriculture, a Member is entitled to grant export subsidies within the limits of the reduction commitment specified in its Schedule. Where a Member claims that another Member has acted inconsistently with Article 3.3 by granting export subsidies in excess of a quantity commitment level, there are two separate parts to the claim. First, the responding Member must have exported an agricultural product in quantities exceeding its quantity commitment level. If the quantities exported do not reach the quantity commitment level, there can be no violation of that commitment, under Article 3.3. However, merely exporting a product in quantities that exceed the quantity commitment level is not inconsistent with the commitment. The commitment is an undertaking to limit the quantity of exports that may be subsidized and not a commitment to restrict the volume or quantity of exports as such. The second part of the claim is, therefore, that the responding Member must have granted export subsidies with respect to quantities exceeding the quantity commitment level. There is, in other words, a quantitative aspect and an export subsidization aspect to the claim.

71. Under the usual rules on burden of proof, the complaining Member would bear the burden of proving both parts of the claim. However, Article 10.3 of the Agreement on Agriculture partially alters the usual rules. The provision cleaves the complaining Member's claim in two, allocating to different parties the burden of proof with respect to the two parts of the claim we have described.

72. Consistent with the usual rules on burden of proof, it is for the complaining Member to prove the first part of the claim, namely that the responding Member has exported an agricultural product in quantities that exceed the responding Member's quantity commitment level.

73. If the complaining Member succeeds in proving the quantitative part of the claim, and the responding Member contests the export subsidization aspect of the claim, then, under Article 10.3, the responding Member "must establish that no export subsidy ... has been granted" in respect of the excess quantity exported. (emphasis added) The language of Article 10.3 is clearly intended to alter the generally-accepted rules on burden of proof. The verb "establish" is synonymous with the verbs "demonstrate" and "prove". Moreover, the auxiliary verb "must" conveys that the responding Member has an obligation–or legal burden–to "establish" or "prove" that "no export subsidy ... has been

granted".

74. The plain meaning of the text is borne out by the immediate context of Article 10.3 of the Agreement on Agriculture. Article 10 is entitled "Prevention of Circumvention of Export Subsidy Commitments". As a subparagraph of this provision, Article 10.3 pursues this aim. The significance of Article 10.3 is that, where a Member exports an agricultural product in quantities that exceed its quantity commitment level, that Member will be treated as if it has granted WTO-inconsistent export subsidies, for the excess quantities, unless the Member presents adequate evidence to "establish" the contrary. This reversal of the usual rules obliges the responding Member to bear the consequences of any doubts concerning the evidence of export subsidization. Article 10.3 thus acts as an incentive to Members to ensure that they are in a position to demonstrate compliance with their quantity commitments under Article 3.3.

75. With respect to the export subsidization part of the claim, the complaining Member, therefore, is relieved of its burden, under the usual rules, to establish a prima facie case of export subsidization of the excess quantity, provided that this Member has established the quantitative part of the claim. We, therefore, do not agree with the Panel that the complaining Member must make out a prima facie case in support of this part of its claim. In practice, the complaining Member may wish to present evidence to rebut any evidence presented by the responding Member. However, the complaining Member is not required to lead in the presentation of evidence to panels, and it might well succeed in its claim even if it presents no evidence--should the responding Member fail to meet its legal burden to establish that no export subsidy has been granted with respect to the excess quantity.

76. We, therefore, find that the Panel erred . . . in its interpretation of Article 10.3 of the Agreement on Agriculture, by imposing upon the complaining Members the duty to make out a prima facie case in support of all aspects of their claims under Articles 3.3, 8, 9.1(c), and 10.1. When the Panel had determined that the complainants had established that Canada had exported dairy products in quantities exceeding its quantity commitment levels, it should have proceeded directly to require Canada to establish that the exports of dairy products did not benefit from export subsidies. Instead, the Panel's next step was to require the complaining Members to "make a prima facie showing that the elements of the claimed export subsidies are present." However, as the Panel found that the complaining Members had made out such a prima facie case, the Panel went on correctly to hold that it is for Canada "to establish that Canadian exports of cheese and 'other milk products' do not benefit from these particular types of export subsidies."

77. Thus, although the Panel's interpretation was in error, this error does not vitiate any of the Panel's findings under Articles 3.3, 8, 9.1(c), and 10.1 of the Agreement on Agriculture. The Panel found that the complaining Members had made out a prima facie case that CEM involved export subsidies. Although the Panel should not have engaged in this inquiry, the inquiry led the Panel to find, correctly, that Canada was obliged to prove that it had not granted export subsidies for the dairy products exported in excess of the quantity commitment level. The Panel, therefore, arrived at the legal situation envisaged by Article 10.3 and, thereafter, properly applied the rules on burden of proof in that provision with respect to proof of the export subsidization aspect of the claim. The Panel concluded that Canada "failed to establish" that CEM did not involve export subsidies. We will examine, below, the appeals that Canada makes against this finding under Articles 9.1(c) and 10.1 of the Agreement on Agriculture. However, we see no reason to disturb these findings on the grounds that the Panel misinterpreted Article 10.3.

VI. Article 9.1(c) of the Agreement on Agriculture–"Payments Financed by Virtue of Governmental Action"

78. The second issue appealed by Canada is whether the Panel erred in its interpretation and application of Article 9.1(c) of the Agreement on Agriculture. This issue raises two separate questions: (a) whether the Panel erred in finding that CEM involves "payments" under Article 9.1(c); and (b) having found that CEM involves "payments", whether the Panel erred in finding that these "payments" are "financed by virtue of governmental action". . . .

A. "Payments"

80. The Panel began its reasoning by recalling that "payments" under Article 9.1(c) of the Agreement on Agriculture include "payments-in-kind" made through the supply of goods or services. The Panel noted that we held, in the first Article 21.5 proceedings, that the existence of payments-in-kind, for purposes of CEM, should be determined by comparing CEM prices with "some objective standard ... reflect[ing] the proper value" of milk to the producer. The Panel also observed that we held that "the average total cost of production represents the appropriate standard" in these proceedings.

81. Before the Panel, the parties disagreed as to how the average total cost of production standard (the "COP standard") should be determined. The Panel "doubted" that Canada was correct to argue that the standard should be each individual producer's costs of production, rather than a single industry-wide average figure, as proposed by the complaining Members. The Panel also found that Canada did not demonstrate why imputed costs for family labour and management, and for owner's equity, as well as quota, transport, marketing, and administrative costs, should not be included in calculating the COP standard, as suggested by the complaining Members.

82. Despite these doubts regarding Canada's position, the Panel made two distinct findings on the existence of "payments"; one based on Canada's interpretation of the COP standard and the other based on the complaining Members' interpretation. The Panel ruled that, even assuming Canada's interpretation of the standard were correct, the evidence submitted by Canada did not support Canada's position that payments were not made. The Panel also considered that the complaining Members' evidence was sufficient to establish a prima facie case that payments were made, on the basis of their interpretation of the COP standard.

83. As the Panel came to an identical conclusion under both interpretations of the COP standard, it concluded that it was "unnecessary [for it] to decide in this case which of these two interpretations is the correct one."[69] Therefore, the Panel did not express any definitive views on the proper application of the COP standard.

84. In its appeal, Canada makes four primary arguments on the question of "payments". Canada contends: first, that the Panel erred in considering that the COP standard should be applied on an industry-wide basis; second, that the Panel erred in finding that the COP standard includes "non-monetary costs", such as the costs of family labour and management, and of owner's equity, that do not represent actual cash costs incurred by the producer; third, that the Panel erred in finding that the COP standard

69. . . . We note, however, that the Panel also stated, in paragraph 5.126 of the Panel Report, that "imputed costs of family labour, return to management, return to equity, and production quota, as well as transport, marketing and administrative costs ... are properly to be included in a calculation of the average total cost of production."

extends to costs associated with selling milk, such as quota, transport, marketing, and administrative costs, whereas Canada submits that it covers only the on-farm costs of producing milk; and fourth, that the Panel erred in its assessment of the evidence by placing a burden on Canada that it "cannot possibly be expected to meet". . . .

1. General Remarks on Article 9.1(c) of the Agreement on Agriculture

85. The word "payment", in Article 9.1(c) of the Agreement on Agriculture, denotes a "transfer of economic resources". Although a monetary payment certainly involves such a transfer, the same is equally true where goods or services are transferred for less than full value. Recognizing this, we upheld the original panel's finding that the ordinary meaning of the word "payment", in Article 9.1(c) of the Agreement on Agriculture, "encompasses 'payments' made in forms other than money".

86. In these second Article 21.5 proceedings, New Zealand and the United States assert that non-monetary "payments" are effected through the supply of goods–CEM. The issue is, therefore, whether supplies of CEM, by Canadian producers, involve a transfer of economic resources to processors.

87. In examining this question in the first Article 21.5 proceedings, we took into account 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 government. Moreover, "payments" need not be funded from government resources, provided they are "financed by virtue of governmental action". Article 9.1(c), therefore, contemplates that "payments" may be made and funded by private parties, without the type of governmental involvement ordinarily associated with a subsidy. Furthermore, the notion of payments encompasses a diverse range of practices involving monetary transfers, or transfers-in-kind. We, therefore, determined that, in identifying whether "payments" are made, it is necessary to consider the particular features of the alleged "payments", by whom they are made, and in what circumstances. Thus, we found that the standard for determining the existence of "payments" under Article 9.1(c) must be identified after careful scrutiny of the factual and regulatory setting of the measure.

88. In the case of CEM, we took into account the fact that the alleged "payments" are made by private parties through the supply of milk. Moreover, subject to the requirement to pre-commit sales of CEM, the private parties are entirely free to produce milk for sale as CEM, and it is for them to agree the price, volume, and timing of the sale with the buyers. In these particular circumstances, we considered that the determination of whether "payments" are made depends on a comparison between the price of CEM and an "objective standard or benchmark which reflects the proper value of the [milk] to [its] provider". We found that, in the circumstances of this dispute, the standard for determining the proper value of CEM is the average total cost of production of the milk (the COP standard), as this standard represents the economic resources the producer invests in the milk. If CEM is sold at less than its proper value, "payments" are made, because there is a transfer of the portion of economic resources not reflected in the selling price.

89. We also provided certain guidance on the determination of the COP standard:

> The average total cost of production would be determined by dividing the fixed and variable costs of producing all milk, whether destined for domestic or export markets, by the total number of units of milk produced for both these markets. . . .

2. Individual Producer's Costs of Production or Industry-wide Average

91. Canada argues that the Panel erred in considering that the COP standard is a single, industry-wide average cost of production figure, rather than each individual producer's costs of production.[79]

92. Although the Panel expressed "doubts" that the COP standard should be each individual producer's costs, rather than an industry-wide figure, we note that it did not reach a definitive view on this question. Instead, as we said, the Panel examined the evidence from the perspective of the alternative positions, and found against Canada under each of them.

93. Canada asserts that we found, in the first Article 21.5 proceedings, that the COP standard is based on individual producer's costs of production. However, this question was not specifically examined, nor resolved, in the first Article 21.5 proceedings.

94. . . . Pursuant to [the Agreement on Agriculture], Canada has undertaken a number of different obligations. Among these are the obligations in Articles 3.3 and 8 of the Agreement on Agriculture not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule. Accordingly, under Article 3.3, Canada has undertaken not to provide the export subsidies listed in Article 9.1 "in excess of ... [its] quantity commitment levels".

95. However, under Article 9.1(c) of the Agreement on Agriculture, it is not solely the conduct of WTO Members that is relevant. We have noted that Article 9.1(c) describes an unusual form of export subsidy in that "payments" can be made and funded by private parties, and not just by government. The conduct of private parties, therefore, may play an important role in applying Article 9.1(c). Yet, irrespective of the role of private parties under Article 9.1(c), the obligations imposed in relation to Article 9.1(c) remain obligations imposed on Canada. It is Canada, and not private parties, which is responsible for ensuring that it respects its export subsidy commitments under the covered agreements. Thus, under the Agreement on Agriculture, any "export subsidies" provided through private party action in Canada are deemed to be provided by Canada, and count towards Canada's export subsidy commitment levels.

96. We believe that the standard for determining the existence of "payments", under Article 9.1(c), should reflect the fact that the obligation at issue is an international obligation imposed on Canada. The question is not whether one or more individual milk producers, efficient or not, are selling CEM at a price above or below their individual costs of production. The issue is whether Canada, on a national basis, has respected its WTO obligations and, in particular, its commitment levels. It, therefore, seems to us that the benchmark should be a single, industry-wide cost of production figure, rather than an indefinite number of cost of production figures for each individual producer. The industry-wide figure enables cost of production data for producers, as a whole, to be aggregated into a single, national standard that can be used to assess Canada's compliance with its international obligations. . . .

98. We, therefore, find that the COP standard for determining whether the sale of CEM involves "payments", under Article 9.1(c) of the Agreement on Agriculture, is an

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79. We note that, although Canada argues that the COP standard should be each individual producer's costs of production, Canada presented evidence based on ten industry-wide groupings, giving an average cost of production figure for each of these groups. For each group or "decile", Canada gave the lowest and highest individual cost of production figure. The Panel also makes this point: "While speaking of the costs to individual producers, not industry-wide average costs, Canada has only provided the Panel with average costs, albeit averages within ten groupings of producers." (Panel Report, para. 5.64)

industry-wide average figure that aggregates the costs of production of all producers of milk. Although the Panel did not express any firm view on this issue, we see no error in the Panel's treatment of this question.

3. Imputed Costs

99. Canada objects to the inclusion, in the COP standard, of an imputed amount for the costs of the producer's family labour and management, and for the costs of owner's equity. Canada contends that, as the producer does not incur a cash cost for these items, they are not relevant because the COP standard does not include "non-monetary" costs. Rather, Canada says, these items are rewarded by any profits earned if revenues from milk sales exceed costs.

100. The Panel did not find that these imputed costs are to be included in the COP standard nor that they are to be excluded from it. Instead, the Panel examined the evidence from the perspective of these two positions, and found against Canada under each of them.[85]

101. In examining this issue, we recall that the notion of "payment", in Article 9.1(c), covers transfers of economic resources, irrespective of the means by which the resources are transferred. Thus, the transfer may be effected in monetary form or equally by a transfer of goods or services for less than full value.

102. In these proceedings, the purpose of the COP standard is precisely to determine whether supplies of CEM involve payments-in-kind that are made in a form other than money. If the COP standard were confined solely to cash costs, as Canada argues, this would overlook the possibility of "payments" being made in the form of non-cash resources invested in the production of milk. Thus, the COP standard must cover all of the economic resources invested in the production of milk and which may be transferred, irrespective of whether the resources involve an actual cash cost.

103. We are satisfied that any labour or management services provided by the farmer's family to the dairy enterprise are relevant economic resources invested in the production of milk and must be included in the COP standard. For the dairy farmer, and his or her family, the investment of services in the dairy enterprise has an economic cost, as those services cannot be put to an alternative remunerative use. We observe that both the United States and New Zealand submitted evidence to the Panel in support of the view that, from the perspective of economic theory, any labour and management services provided to an enterprise involve such an economic "opportunity" cost. Moreover, we believe that remuneration of family labour and management services is not part of the profits of the dairy farm. Rather, profits are the proceeds remaining after all costs, including such salary costs, have been accounted for.

104. The same is also true of any equity the owner invests in the dairy enterprise. The allocation of such capital is, clearly, an investment of economic resources and carries an economic opportunity cost to the owner because the capital cannot simultaneously be invested elsewhere.[88] Again, the profits of the dairy enterprise are the proceeds after all costs, including the cost of equity, have been accounted for.

105. Moreover, it would be incongruous if the costs of family labour and management

85. Panel Report, para. 5.90. We note, however, that the Panel also "recalled", in paragraph 5.126 of the Panel Report, that these imputed costs "are properly to be included in a calculation of the average total cost of production."

88. The documentary evidence submitted by New Zealand and the United States is equally supportive of the view that, in economic theory, investment of equity involves an economic opportunity cost. (Ibid.)

were excluded from the COP standard when provided by family, but included when provided by others.[89] Likewise, it would be curious if the cost of capital, of which equity is one type, were excluded from the COP standard when capital is provided through the owner's equity, but included when it is provided through, for instance, debt, merely because the cost of debt is expressed in recurring cash outlays for interest payments. In each case, the dairy enterprise is incurring an economic cost and that cost should be appropriately reflected in the costs of production.

106. Accordingly, we find that any failure to include in the COP standard the costs of family labour and management, or of owner's equity, would understate the costs of milk production, and may lead to a non-monetary "payment" going undetected. . . .

110. We, therefore, find that the COP standard for determining whether "payments" exist, under Article 9.1(c) of the Agreement on Agriculture, includes all monetary and non-monetary economic costs of production, such as the costs of family labour and management, and of owner's equity. We see no error in the Panel's approach to this issue.

4. Selling Costs

111. Canada suggests that, for purposes of Article 9.1(c) of the Agreement on Agriculture, only the farm-based costs of producing milk should be taken into account in the COP standard, so that the costs of selling milk–such as quota, transport, marketing, and administrative costs–would be excluded.

112. The Panel did not find that these selling costs are to be included in the COP standard, nor that they are to be excluded from it. Instead, the Panel examined the evidence from the perspective of both positions and found against Canada under each of them.[94]

113. We recall that the COP standard represents the producer's investment of economic resources in milk and, hence, in these proceedings, the proper value of the milk to the producer. In our view, costs incurred by the producer in selling milk are as much a part of the economic resources the producer invests in the milk as are farm-based production costs. Indeed, the costs incurred to make sales are a vital part of the process by which the producer earns revenues through producing milk. If the producer sells milk at a price sufficient to cover only the farm-based production costs, it transfers to the processor any resources invested in selling the milk, such as the value of transport, marketing, and administration. There would, in such circumstances, be a "payment" of the value of these additional selling costs. Accordingly, these costs must be included in the COP standard in the comparison with the sales price of CEM. . . .

116. Accordingly, we find that any transport, marketing, and administrative costs are to be included in the COP standard applied under Article 9.1(c), as are any costs of acquiring and retaining quota. The Panel committed no error of law in its assessment of

89. We note that, according to the Canadian Dairy Commission Handbook ("CDC Handbook"), family labour and management is treated as an imputed, non-cash cost, "regardless of whether or not the family member is paid for his/her labour". . . . Thus, in some cases there may be an actual cost for family labour and management which is excluded by the CDC and replaced by an imputed cost using the CDC's methodology. Canada's argument would, in fact, exclude both an actual cost incurred by the dairy enterprise and an imputed cost. We note also that the CDC Handbook defines a family member in broad terms to include: "the producer, the producer's spouse, children, brothers, sisters, sons-in-law, daughters-in-law and parents." . . .

94. Panel Report, para. 5.90. We note, however, that the Panel also "recalled", in paragraph 5.126 of the Panel Report, that the cost of quota, and transport, marketing and administrative costs "are properly to be included in a calculation of the average total cost of production."

these costs.

5. Assessment of Evidence

117. We recall that the Panel examined the evidence from two different perspectives–that is, using both the complaining Members' and Canada's proposed COP standards. The Panel found that, under both of these standards, "payments" were being made through the supply of CEM.

118. Canada submits that the Panel erred in its assessment of the evidence by placing a burden on Canada that it "cannot possibly be expected to meet." Canada's argument relates to the Panel's assessment of the evidence using Canada's proposed COP standard, that is, a COP standard applied on an "individual", as opposed to an "industry-wide" basis, and excluding from the COP standard, the costs of family labour and management, and of owner's equity, and also quota, transport, marketing, and administrative costs.

119. We have held that the COP standard is to be determined on an industry-wide basis and that it includes all the costs that Canada proposed be excluded, as they involve economic resources invested in the production of milk. As such, the Panel's examination of the evidence from Canada's perspective is rendered moot, because it is based on a legal standard that we have found to be the incorrect one. Any review of the Panel's treatment of the evidence must, instead, focus on its examination of the evidence which included the various costs Canada proposed to exclude. That is, we must review the Panel's comparison of the price of CEM with the COP standard including the costs of family labour and management, and of owner's equity, and also quota, transport, marketing, and administrative costs.

120. . . . [A]s the Panel found, on an industry-wide basis, CEM prices are significantly below the COP standard. On the basis of this evidence, the Panel found that there was a prima facie case that "payments" are being made. Moreover, under Article 10.3 of the Agreement on Agriculture, the burden of proof was on Canada to establish the contrary. The Panel found that Canada had not satisfied that burden. We can see no error in the Panel's assessment of the evidence.[105] . . .

B. "Financed by Virtue of Governmental Action"

122. We turn now to the second element of Canada's appeal of the Panel's findings under Article 9.1(c) of the Agreement on Agriculture–whether the Panel erred in finding that "payments", made on the sale of CEM, are "financed by virtue of governmental action".

123. The Panel recalled that that there must be a "demonstrable link" between governmental action and the financing of "payments". The Panel proceeded to examine several actions of the Canadian government in regulating the supply of domestic milk and CEM. It concluded that New Zealand and the United States had made out a prima facie case that a demonstrable link exists between these Canadian governmental actions and the financing of CEM payments. Further, the Panel found that Canada had failed to establish, pursuant to Article 10.3 of the Agreement on Agriculture, that these

105. Pursuant to Article 11 of the DSU, a panel must make an objective assessment of the facts. As such, a panel is the trier of facts, responsible for evaluating the credibility and weight of the evidence. As we have stated, we will interfere with a panel's assessment of the evidence only if the panel has exceeded the bounds of its discretion as trier of facts. (Appellate Body Report, US - Wheat Gluten, para. 151)

governmental actions were not demonstrably linked to the financing of the payments.

124. On appeal, Canada argues that the Panel erred under Article 9.1(c) of the Agreement on Agriculture, in particular by finding that a "demonstrable link" exists between Canadian governmental action and the financing of CEM payments. Canada claims that it has removed government action from "every stage of the export transaction" and that producers and processors "freely choose to enter into export transactions". Therefore, Canada argues that no demonstrable link exists between governmental action and financing of CEM payments. [The report then quotes article 9.1(c) of the Agreement on Agriculture.]

126. The phrase "financed by virtue of governmental action" has three distinct elements–"governmental action"; "by virtue of "; and "financed"–which we will address in turn.

127. As regards "governmental action", we held in the first Article 21.5 proceedings that "the text of Article 9.1(c) does not place any qualifications on the types of 'governmental action' which may be relevant under Article 9.1(c)." Instead, the provision gives but one example of governmental action that is "included" in Article 9.1(c)–however, this example is merely illustrative.[110] Accordingly, we stated that Article 9.1(c) "embraces the full-range" of activities by which governments " 'regulate', 'control' or 'supervise' individuals". In particular, we said that governmental action "regulating the supply and price of milk in the domestic market" might be relevant "action" under Article 9.1(c). Moreover, the governmental action may be a single act or omission, or a series of acts or omissions.

128. We observe that Article 9.1(c) does not require that payments be financed by virtue of government "mandate", or other "direction". Although the word "action" certainly covers situations where government mandates or directs that payments be made, it also covers other situations where no such compulsion is involved.[113]

129. Although the term "governmental action", when read in isolation, is somewhat open-ended, perhaps even abstract, the words "by virtue of " clarify further the meaning of this term. In the first Article 21.5 proceedings, we opined:

> The words "by virtue of " indicate that there must be a demonstrable link between the governmental action at issue and the financing of the payments, whereby the payments are, in some way, financed as a result of, or as a consequence of, the governmental action.

130. The words "by virtue of ", therefore, express the relationship between "governmental action" and the "financing" of payments for the purpose of Article 9.1(c). The essence of that relationship is the "nexus" or "link" between "action" and "financing".

131. Thus, although Article 9.1(c) extends, in principle, to any "governmental action", not every governmental action will have the requisite nexus to the financing of payments. In the first Article 21.5 proceedings, we observed that "[g]overnments are constantly engaged in regulation of different kinds in pursuit of a variety of objectives." Yet, we went on to say that regulation that merely enables payments to occur will not

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110. The example given is "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".

113. Article 9.1(c) of the Agreement on Agriculture may be contrasted with Article 9.1(e) of the Agreement on Agriculture, as well as with Article 1.1(a)(1)(iv) of the SCM Agreement, and items (c), (d), (j), and (k) of the Illustrative List of Export Subsidies (the "Illustrative List") of the SCM Agreement. In these provisions, some kind of government mandate, direction, or control is an element of a subsidy provided through a third party.

suffice for those payments to be regarded as "financed by virtue of governmental action". We stated:

> [Where regulation merely enables payments to occur], the link between the governmental action and the financing of the payments is too tenuous for the "payments" to be regarded as "financed by virtue of governmental action" ... within the meaning of Article 9.1(c). Rather, there must be a tighter nexus between the mechanism or process by which the payments are financed ...

132. This brings us to the meaning of the word "financing". The word refers generally to the mechanism or process by which financial resources are provided to enable "payments" to be made. The word could, therefore, be read to mean that government itself must provide the resources for producers to make payments. However, Article 9.1(c) expressly precludes such a reading, as it states that "payments" need not involve "a charge on the public account". This is borne out by the fact that the text indicates that "financing" need only be "by virtue of governmental action", rather than "by government" itself. Article 9.1(c), therefore, contemplates that "payments may be financed by virtue of governmental action even though significant aspects of the financing might not involve government." Indeed, as we have said, payments may be made, and funded, by private parties.

133. The word "financing" must, nonetheless, be given meaning. Accordingly, even if government does not fund the payments itself, it must play a sufficiently important part in the process by which a private party funds "payments", such that the requisite nexus exists between "governmental action" and "financing".

134. These general remarks illustrate well that "[i]t is extremely difficult ... to define in the abstract the precise character of the required link between the governmental action and the financing of the payments, particularly where payments-in-kind are at issue." In each case, the alleged link must be examined taking account of the particular character of the governmental action at issue and its relationship to the payments made.

135. With this mind, we turn to the facts of this dispute. We recall that we have described the key features of the Canadian regulatory system in paragraphs 12-14 of this Report.

136. We have also upheld the Panel's finding that producers make "payments", under Article 9.1(c) of the Agreement on Agriculture, to processors through sales of CEM at prices that are below the COP standard. As a result, producers' sales revenues do not recoup all of the costs associated with producing and selling CEM. As this short-fall in revenues must be "financed" from some other source, sales of CEM necessarily involve the "financing" of "payments". The crucial question is the source of that financing and, in particular, whether the financing occurs "by virtue of governmental action".

137. The Panel considered that "a significant percentage" of Canadian milk producers are able to cover the entirety of fixed and variable costs of production through in-quota sales of domestic milk. As a result, the Panel opined, these producers can afford to make export sales at marginal cost. The Panel found that governmental action regulating the domestic milk market "cross-subsidizes many sales that otherwise would not be made or would at least constitute sales at a loss."

138. We note that CEM is produced almost exclusively by the same producers who

supply milk to the domestic market.[124] It is not contested that these producers use the same production facilities to produce domestic and export milk–that is, the same land, cattle, buildings, machinery, milking facilities, and so on. Indeed, in some provinces, even after production, both regulatory classes of milk have common storage and transportation facilities. There is, in other words, a single line of production for all milk, whatever its destination market.

139. Where fungible goods, such as milk, are produced using a single line of production, but sold in two different markets, the fixed costs of production are, in principle, shared between sales revenues from both markets. However, in the event that one of the two markets offers much higher revenues, a disproportionately large part, possibly even all, of the shared fixed costs may be borne by sales made in the more remunerative market.

140. Where sales in the more remunerative market bear more than their relative proportion of shared fixed costs, sales in the other market do not need to cover their relative proportion of the shared fixed costs in order to be profitable.[126] Rather, these sales can be made profitably below the average total cost of production. If the more remunerative sales cover all fixed costs, sales in the other market can be made profitably at any price above marginal cost. In these situations, the higher revenue sales effectively "finance" a part of the lower revenue sales by funding the portion of the shared fixed costs attributable to the lower priced products.

141. In Canada, the domestic price of milk is fixed by a government agency–the CDC [Canadian Dairy Commission]–on the basis of an annual survey of producers' costs of production. The CDC has a statutory mandate to ensure that, through the administered price, a "fair return" is secured for "efficient producers". The CDC sets this administered price on the basis of data covering 70 percent of producers, such that these 70 percent of producers can, on average, cover all of their costs of production, including all fixed costs, through domestic sales of milk. Moreover, for other producers, domestic sales will cover a significant part, if not all, of the fixed costs. This suggests, to us, that a large proportion of producers can finance the sale of CEM at a price that is below the COP standard as a result of participation in the domestic market. In that respect, we note also that the domestic milk market represents 96.4 percent, by volume, of total Canadian milk production, with export production representing only 3.6 percent, by volume.

142. We observe that, although there is a large proportion of producers that could sell CEM below the COP standard, the proportion of producers who have actually made at least one CEM sale is around 40 percent of all producers.

143. In these circumstances, we agree with the Panel that the evidence indicates that a "significant percentage" of producers are "likely" to make sales of CEM at below the costs of production as a result of highly remunerative in-quota sales in the domestic market. For these producers, domestic sales are likely to "finance" payments made on the sale of CEM. Although the Panel's finding is based on "likelihood", this likelihood seems, to us, to be rather high. Any producer whose fixed costs have been, in large part, covered by domestic sales, and who has sufficient capacity to produce for the export

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124. According to Canada, approximately 100 milk producers produce CEM without, at the same time, holding a domestic quota. . . . These 100 producers represent approximately 0.5% of all 19,000 Canadian milk producers and 1.25% of all 8000 CEM producers. . . . Moreover, the export market represents only 3.62 percent, by volume, of the total Canadian milk production. . . .

126. Even if sales in the more remunerative market do not cover all of the shared fixed costs, they may bear a higher relative proportion of those costs, such that sales in the less remunerative market can be made at a price below the average total cost of production, because these sales do not need to cover their entire relative proportion of shared fixed costs.

market, has a powerful profit incentive to sell CEM at a competitive export price, even if that price is below the average total cost of production, as long as the price is above marginal costs of production. In any event, we recall that, pursuant to Article 10.3 of the Agreement on Agriculture, Canada bears the burden of proving that sales of CEM do not involve the granting of export subsidies.

144. It falls now to consider the role of the Canadian government in financing payments made on the sale of CEM. We have agreed with the Panel that a significant percentage of producers are likely to finance sales of CEM at below the costs of production as a result of participation in the domestic market. Canadian "governmental action" controls virtually every aspect of domestic milk supply and management.[130] In particular, government agencies fix the price of domestic milk that renders it highly remunerative to producers. Government action also controls the supply of domestic milk through quota, thereby protecting the administered price. The imposition by government of financial penalties on processors that divert CEM into the domestic market is another element of governmental control over the supply of milk. Further, the degree of government control over the domestic market is emphasized by the fact that government pools, allocates, and distributes revenues to producers from all domestic sales. Finally, governmental action also protects the domestic market from import competition through tariffs.[131]

145. In our view, the effect of these different governmental actions is to secure a highly remunerative price for sales of domestic milk by producers. In turn, it is due to this price that a significant proportion of producers covers their fixed costs in the domestic market and, as a result, has the resources profitably to sell export milk at prices that are below the costs of production.

146. Accordingly, we agree with the Panel that "governmental action" in the domestic market plays a critical part in the "financing" of payments made by a significant percentage of producers on the sale of CEM. As such, we agree with the Panel that payments made through the supply of CEM at below the COP standard are financed by virtue of this governmental action. We also agree with the Panel that Canada failed to establish the contrary, pursuant to Article 10.3 of the Agreement on Agriculture.

147. We do not agree with Canada that the circumstances indicate that the Canadian government has merely created a regulatory framework whereby it has enabled producers to sell CEM at prices that are below the costs of production. Certainly, producers decide for themselves whether and when to sell CEM. However, governmental action in the domestic market goes further than simply creating a regulatory environment in which producers choose to make export payments using their own resources. Rather, as we have said, Canadian governmental action is instrumental in providing a significant percentage of producers with the resources that enable them to sell CEM at below the costs of production.

148. Canada also objects that this reasoning brings "cross-subsidization" under

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130. . . . In [the original] proceedings, we found that the agencies managing the supply of milk were "government" agencies. (Appellate Body Report, Canada - Dairy, para. 118)

131. For instance, in its Schedule, Canada has established a tariff quota of 64,500 tonnes for fluid milk (tariff headings 0401.10.10 and 0401.20.10) for cross-border purchases imported by Canadian consumers, with an in-quota tariff rate of 7.5 percent since 2001; outside this tariff quota, since 2001, Canada's bound tariff is 241.3 percent, but not less than C$34.5/hl. For yogurt (tariff heading 0403.10), the tariff quota is 332 tonnes and is limited to yogurt in retail-sized containers only; outside this quota, since 2001, the applicable bound tariff rate is 237.5 percent, but not less than 46.6¢/kg. "Fresh (unripened or uncured) cheese" (tariff heading 0406.10) falls under a tariff quota of 20,411,866 tonnes; outside this quota, since 2001, the applicable bound tariff rate is 245.6 percent, but not less than 451.1¢/kg.

Article 9.1(c) of the Agreement on Agriculture.[133] We have explained that the text of Article 9.1(c) applies to any "governmental action" which "finances" export "payments". The text does not exclude from the scope of the provision any particular governmental action, such as regulation of domestic markets, to the extent that this action may become an instrument for granting export subsidies. Nor does the text exclude any particular form of financing, such as "cross-subsidization". Moreover, the text focuses on the consequences of governmental action ("by virtue of which") and not the intent of government. Thus, the provision applies to governmental action that finances export payments, even if this result is not intended. As stated in our Report in the first Article 21.5 proceedings, this reading of Article 9.1(c) serves to preserve the legal "distinction between the domestic support and export subsidies disciplines of the Agreement on Agriculture". Subsidies may be granted in both the domestic and export markets, provided that the disciplines imposed by the Agreement on the levels of subsidization are respected. If governmental action in support of the domestic market could be applied to subsidize export sales, without respecting the commitments Members made to limit the level of export subsidies, the value of these commitments would be undermined. Article 9.1(c) addresses this possibility by bringing, in some circumstances, governmental action in the domestic market within the scope of the "export subsidies" disciplines of Article 3.3.

149. In our view, the nexus between the Canadian governmental actions in regulating the domestic market and the financing of payments made on the sale of CEM is sufficient, on its own, for us to uphold the Panel's finding that these payments are financed "by virtue of " governmental action. However, we note that, besides these actions, the Panel also relied on other forms of governmental action in support of its conclusion on this issue. The first of these was that processors are exempt from paying the higher domestic price for milk when they purchase CEM. [FN136] We do not believe that this action influences the "financing" of payments by the producer. Certainly, this action explains why the processor of CEM is not required to pay the higher domestic price for CEM. However, the mere fact that the processor is not obliged to buy CEM at the domestic price does not demonstrate a link between this exemption and the financing of payments by the producer on the sale of CEM. The exemption is, in short, not linked to the mechanism by which the producer funds the payments.

150. The second other form of governmental action relied on by the Panel was "the prohibition on the diversion of CEM back into the domestic regulated market". We have already mentioned this factor in our analysis of governmental action.

151. The final governmental action relied on by the Panel was the requirement for producers to pre-commit to sell CEM. The Panel found that this requirement creates "an additional incentive" to sell a larger quantity of CEM than would be the case if producers could decide to sell to that market "ex post ". Although this may be the case, we also consider it possible that producers are able to make a reasonably accurate prediction of production levels, particularly as pre-commitment occurs on a 30-day basis. Further, we think producers are just as likely to err on the side of caution to ensure that CEM sales do not prejudice their ability to exhaust their quota entitlement to sell milk at the higher domestic price. In the light of these doubts, we attach no weight to the pre-commitment requirement.

133. The Panel used this term to describe the fact that sales revenues from one market–the domestic market–finance a portion of the costs associated with sales made in another market--the CEM market. (Panel Report, paras. 5.127, 5.130, and 5.134)

152. Before concluding, we wish to comment on Canada's arguments concerning the approximately 100 producers out of the 8,000 who sell CEM, and out of the total of 19,000 producers that do not participate in the domestic market at all and sell solely CEM. Canada argues that the Panel erred in finding that, for these producers, sales of CEM involve payments "financed by virtue of governmental action". We do not believe that it is necessary for us to make any findings regarding these 100 producers. The complaint made by New Zealand and the United States is that Canada has acted inconsistently with its export subsidy commitments under the Agreement on Agriculture. Canada may act inconsistently with these commitments, as we have found, even if some producers never make payments financed by virtue of governmental action.

153. We also wish to emphasize that we do not suggest that Canada's domestic supply management system is inconsistent with Canada's obligations under the covered agreements and, specifically, the Agreement on Agriculture. The consistency of Canada's domestic milk supply management system is not at issue in these proceedings. However, pursuant to Articles 3.3, 8, and 9.1(c) of the Agreement on Agriculture, Canada must ensure that it confines, to its export subsidy reduction commitment levels, any export "payments" which are "financed by virtue of " the governmental action Canada takes to regulate the domestic milk market.

154. In conclusion, therefore, we uphold the Panel's finding . . . that the supply of CEM, by producers to processors, involves payments which are "financed by virtue of governmental action", within the meaning of Article 9.1(c) of the Agreement on Agriculture. . . .

VII. Article 10.1 of the Agreement on Agriculture–“Export Subsidies"

157. Canada also appeals the Panel's alternative finding . . . that, if the CEM scheme does not involve export subsidies under Article 9.1(c) of the Agreement on Agriculture, it nevertheless constitutes export subsidies under Article 10.1 of that Agreement. In making this alternative finding, the Panel recalled that Article 10.1 of the Agreement on Agriculture is residual in character to Article 9.1 of the Agreement on Agriculture and that a measure cannot simultaneously be an export subsidy under both Article 9.1 and Article 10.1. The Panel stated that its alternative finding under Article 10.1 of the Agreement on Agriculture would be relevant only if we were to reverse its finding that the CEM scheme falls within Article 9.1(c) of that Agreement.

158. As we have concluded that the CEM scheme involves export subsidies under Article 9.1(c) of the Agreement on Agriculture, those subsidies cannot, by definition, simultaneously be export subsidies under Article 10.1. Therefore, the condition on which the Panel premised its alternative finding under Article 10.1 of the Agreement on Agriculture does not arise. In these circumstances, both the Panel's reasoning and its finding under Article 10.1 of the Agreement on Agriculture are moot and of no legal effect. There is, therefore, no reason for us to rule upon Canada's appeal of the Panel's finding under Article 10.1, nor to make any finding under this provision.

NOTES AND QUESTIONS

1. Recall paragraph 10 of the Appellate Body’s report. On what basis do Argentina and the EU have the authority to file a “third participant's submission”? What is the basis for Australia’s participation at the oral hearing? Are there differences in the status of these third parties? (In this regard, review DSU arts. 4, 10.)

2. Review paragraphs 56-77 of the report. In general, what are the rules of evidence that apply to the burden of proof before a DSU panel? From what source does the Appellate Body derive these rules? What are the arguments of the participants concerning burdens under the Agreement on Agriculture, art. 10.3? How does the Appellate Body resolve these issues?

3. How much deference does the Appellate Body give to the panel? What is the standard of judicial review of legal conclusions of the panel? Of factual findings? (In this regard, see note 105, *supra*.)

4. Review paragraphs 91-98 of the report. Why should the existence of an impermissible subsidy be considered on the basis of an industry-wide cost average, rather than the individual costs of the producers claimed to be benefitting from the alleged subsidy? How does this compare with the analysis of subsidies under the SCM agreement?

5. In light of paragraphs 96 and 122-154 of the report, what is Canada supposed to do to comply with its international obligations under the Agreement on Agriculture?

6. Review paragraphs 157-158 of the report. Why cannot "export subsidies under Article 9.1(c) of the Agreement on Agriculture . . . simultaneously be export subsidies under Article 10.1"?

3. Exhibit B: EU v. U.S.

In 1998, the EU challenged the FSC provisions of U.S. tax law, arguing that they represented prohibited export and import substitution subsidies under the SCM Agreement, and that they also violated the Agreement on Agriculture. In 1999 the panel established to hear the dispute found that the tax exemption granted by the FSC provisions did violate the two agreements, but the panel did not make adverse findings with respect to FSC pricing rules or the import substitution claim.[1] It recommended that the FSC subsidies be withdrawn by the United States by October 1, 2000. The United States filed an appeal, and in February 2000 the Appellate Body ruled in favor of the panel's finding that the FSC provisions were a prohibited export subsidy under the SCM Agreement, found on other grounds that the Agreement on Agriculture had been violated, and declined to address the pricing rules or the import substitution claim. The panel and Appellate Body reports were adopted in March 2000, and the United States announced that it would comply. In November 2000, the FSC Replacement and Extraterritorial Income Exclusion Act (the "ETI Act") was signed into law, repealing and replacing the FSC provisions. The EU claimed that the ETI Act violated the two agreements and article III, paragraph 4 of the GATT itself. Arbitration over the appropriate amount of retaliation by the EU for the original findings (claimed by the EU to be approximately $4 billion) was suspended pending resolution of the new dispute. The panel was reestablished to hear the new dispute in December 2000. In August 2000, it found that the ETI Act violated the two agreements and the GATT. The United States once again appealed, and the following report was issued by the Appellate Body.

UNITED STATES–TAX TREATMENT FOR

1. *See* Elizabeth Olson, *U.S. Loses a Trade Dispute With Europe*, N.Y. Times, June 23, 2001, at B2, col. 4 (discussing implications of dispute).

"FOREIGN SALES CORPORATIONS" RECOURSE TO ARTICLE 21.5 OF THE DSU BY THE EUROPEAN COMMUNITIES

WT/DS108/AB/RW, AB-2001-8, January 14, 2002

I. Introduction

1. The United States appeals certain issues of law and legal interpretations in the Panel Report, United States–Tax Treatment for "Foreign Sales Corporations"–Recourse to Article 21.5. of the DSU by the European Communities (the "Panel Report"). The Panel was established to consider a complaint by the European Communities concerning the consistency of the United States FSC Replacement and Extraterritorial Income Exclusion Act (the "ETI Act")[2] with the Agreement on Subsidies and Countervailing Measures (the "SCM Agreement"), the Agreement on Agriculture, and the General Agreement on Tariffs and Trade 1994 (the "GATT 1994"). The ETI Act is a measure taken by the United States with a view to complying with the recommendations and rulings of the Dispute Settlement Body (the "DSB") in United States–Tax Treatment for "Foreign Sales Corporations" ("US - FSC").[3] . . .

4. . . . On 20 December 2000, in accordance with Article 21.5 of the DSU, the DSB referred the matter to the original panel. The Panel Report was circulated to the Members of the World Trade Organization (the "WTO") on 20 August 2001.

5. The Panel concluded that:

> (a) the [ETI] Act is inconsistent with Article 3.1(a) of the SCM Agreement as it involves subsidies "contingent... upon export performance" within the meaning of Article 3.1(a) of the SCM Agreement by reason of the requirement of "use outside the United States" and fails to fall within the scope of the fifth sentence of footnote 59 of the SCM Agreement because it is not a measure to avoid the double taxation of foreign-source income within the meaning of footnote 59 of the SCM Agreement;
>
> (b) the United States has acted inconsistently with its obligation under Article 3.2 of the SCM Agreement not to maintain subsidies referred to in paragraph 1 of Article 3 of the SCM Agreement;
>
> (c) the [ETI] Act, by reason of the requirement of "use outside the United States", involves export subsidies as defined in Article 1(e) of the Agreement on Agriculture for the purposes of Article 10.1 of the Agreement on Agriculture and the United States has acted inconsistently with its obligations under Article 10.1 of the Agreement on Agriculture by applying the export subsidies, with respect to both scheduled and unscheduled agricultural products, in a manner that, at the very least, threatens to circumvent its export subsidy commitments under Article 3.3 of the Agreement on Agriculture and, by acting inconsistently with Article 10.1, the United States has acted inconsistently with its obligation under Article 8 of the Agreement on Agriculture;
>
> (d) the [ETI] Act is inconsistent with Article III:4 of the GATT 1994 by reason of the foreign articles/labour limitation as it accords less favourable treatment within the meaning of that provision to imported products than to like products of US origin; and

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2. United States Public Law 106-519, 114 Stat. 2423 (2000).

3. The recommendations and rulings of the DSB resulted from the adoption, by the DSB, of the Appellate Body Report in US - FSC, WT/DS108/AB/R, adopted 20 March 2000 (the "original Appellate Body Report"). In this Report, we refer to the panel that considered the original complaint brought by the European Communities as the "original panel" and to its report as the "original panel report".

> (e) the United States has not fully withdrawn the FSC subsidies found to be prohibited export subsidies inconsistent with Article 3.1(a) of the SCM Agreement and has therefore failed to implement the recommendations and rulings of the DSB made pursuant to Article 4.7 SCM Agreement.

6. The Panel also concluded that to the extent the United States had acted inconsistently with the SCM Agreement, the Agreement on Agriculture and the GATT 1994, the United States had nullified or impaired benefits accruing to the European Communities under those agreements.

II. Background

A. Overview of United States Rules of Taxation

12. In our Report in US - FSC, we provided certain general background information relating to United States rules of taxation. We said:

> For United States citizens and residents, the tax laws of the United States generally operate "on a worldwide basis". This means that, generally, the United States asserts the right to tax all income earned "worldwide" by its citizens and residents. A corporation organized under the laws of one of the fifty American states or the District of Columbia is a "domestic", or United States, corporation, and is "resident" in the United States for purposes of this "worldwide" taxation system. ...
>
> The United States generally taxes any income earned by foreign corporations within the territory of the United States. The United States generally does not tax income that is earned by foreign corporations outside the United States. However, [under Section 882(a) IRC], such "foreign-source" income of a foreign corporation generally will be subject to United States taxation when such income is "effectively connected with the conduct of a trade or business within the United States". ... (footnotes omitted)

13. This statement continues to describe the United States tax system and is relevant for the purposes of this appeal also. In addition, we note that, under Sections 1 and 11 IRC, the United States imposes a tax on the "taxable income" of its citizens and residents. According to Section 63(a) IRC, taxable income is equal to "gross income minus the deductions allowed" under the IRC. Section 61(a) IRC provides that gross income is "all income from whatever source derived". When a United States citizen or resident is subject to tax, in the United States, on income which is also subject to tax in a foreign State, the United States grants the taxpayer tax credits, subject to certain limitations, in respect of the amount of foreign taxes paid.[22]

14. The provisions of the IRC relating to these rules of taxation have not been modified by the ETI Act, although the application of these rules has been altered by the adoption of the ETI Act.

B. ETI Act

. . .

16. The ETI Act consists of five sections. At issue in this dispute are, first, certain elements of Sections 2 and 5, which relate to foreign sales corporations and, second,

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22. Section 901(a) IRC.

certain elements of Section 3. Section 3, entitled "Treatment of Extraterritorial Income", amends the IRC by inserting into it a new Section 114, as well as a new Subpart E, which is in turn composed of new Sections 941, 942 and 943. The remaining sections of the ETI Act are not relevant for purposes of this dispute.

17. . . . Section 5(b) prohibits foreign corporations from electing to be treated as FSCs after 30 September 2000 and provides for the termination of inactive FSCs. Nevertheless, Section 5(c) creates a "transition period" for certain transactions of existing FSCs. Specifically, under Section 5(c)(1) of the ETI Act, the repeal of the provisions of the IRC relating to FSCs "shall not apply" to transactions of existing FSCs which occur before 1 January 2002 or to any other transactions of such FSCs which occur after 31 December 2001, pursuant to a binding contract between the FSC and an unrelated person which is in effect on 30 September 2000. These provisions are the subject of the European Communities' claim that the United States has not fully withdrawn the FSC subsidies, in accordance with Article 4.7 of the SCM Agreement.

18. Sections 114, 941, 942 and 943 IRC were inserted into the IRC by virtue of Section 3 of the ETI Act, and create new rules under which certain income is excluded from United States taxation. We refer to these new rules as the "ETI measure" (or sometimes simply as the "measure"). . . . In these proceedings, the claims brought by the European Communities under Article 3.1 of the SCM Agreement, Articles 3.3, 8 and 10.1 of the Agreement on Agriculture and Article III:4 of the GATT 1994 contest various elements of this measure.

19. The tax treatment provided by the ETI measure is available to United States' citizens and residents, including natural persons, corporations and partnerships. In addition, the provisions of the ETI measure also apply to foreign corporations which elect to be treated, for tax purposes, as United States corporations. The ETI measure permits all these taxpayers to elect to have qualifying income taxed in accordance with the provisions of that measure. This election may be made by taxpayers on a transaction-by-transaction basis.

20. Generally, income from specific transactions will qualify for treatment in accordance with the provisions of the ETI measure if it is income attributable to gross receipts: (i) from specific types of transaction; (ii) involving "qualifying foreign trade property" ("QFTP"); and (iii) if the "foreign economic process requirement" is fulfilled with respect to each such transaction. Turning to the first of these conditions, the rules contained in the ETI measure apply, in particular, to income arising from sale, lease or rental transactions. The ETI measure also applies to income earned from the performance of services "related or subsidiary to" qualifying sales or lease transactions, as well as to income earned from the performance of certain other services.[27]

21. The second condition is that these transactions involve QFTP. Section 943(a)(1) IRC defines QFTP as property which is: (A) manufactured, produced, grown or extracted within or outside the United States; (B) held primarily for sale, lease or rental, in the ordinary course of business, for direct use, consumption, or disposition outside the United States; and (C) not more than 50 percent of the fair market value of which is

27. The detailed rules of the ETI measure provide that foreign trading gross receipts may be earned through (i) any sale, exchange, or other disposition of qualifying foreign trade property; (ii) any lease or rental of qualifying foreign trade property; (iii) any services which are related and subsidiary to (i) and (ii); (iv) for engineering or architectural services for construction projects located (or proposed for location) outside the United States; and (v) for the performance of managerial services for a person other than a related person in furtherance of activities under (i), (ii)or (iii). (Section 3 of the ETI Act, Section 942(a) IRC) We will generally refer to sale and lease transactions as a shorthand reference to the transactions described in (i) and (ii) of this footnote.

attributable to: (i) articles manufactured, produced, grown, or extracted outside the United States; and (ii) direct costs for labour performed outside the United States.

22. The third condition is that the "foreign economic process requirement" must be fulfilled with respect to each individual transaction. This requirement is fulfilled if the taxpayer (or any person acting under contract with the taxpayer) participated outside the United States in the solicitation, negotiation, or making of the contract relating to the transaction. Furthermore, a specified portion of the "direct costs" of the transaction must be attributable to activities performed outside the United States.[30]

23. Section 942(a) IRC designates as "foreign trading gross receipts" the receipts generated in transactions satisfying all three of these conditions. Under Section 114(e) IRC, "extraterritorial income" is the gross income attributable to foreign trading gross receipts and, under Section 941(b) IRC, "foreign trade income" is the taxable income attributable to foreign trading gross receipts.

24. Section 114(a) IRC provides that a taxpayer's gross income "does not include extraterritorial income". Section 114(b) IRC adds that this exclusion of extraterritorial income from gross income "shall not apply" to that portion of extraterritorial income which is not "qualifying foreign trade income" ("QFTI"). Accordingly, the only portion of extraterritorial income which is excluded from gross income–and, thereby, from United States taxation–is QFTI.

25. QFTI is an amount which, if excluded from the taxpayer's gross income, will result in a reduction of the taxable income of the taxpayer from the qualifying transaction. Pursuant to Section 941(a)(1) and (2) IRC, QFTI is calculated as the greatest of, or the taxpayer's choice of, the following three options: (i) 30 percent of the foreign sale and leasing income derived by the taxpayer from such transaction; (ii) 1.2 percent of the foreign trading gross receipts derived by the taxpayer from the transaction; or (iii) 15 percent of the foreign trade income derived by the taxpayer from the transaction. . . .

IV. Issues Raised in this Appeal

80. This appeal raises the following issues:

> (a) whether the Panel erred in finding, in paragraphs 8.30 and 8.43 of the Panel Report, that the ETI measure . . . involves the foregoing of revenue which is "otherwise due" and thus gives rise to a "financial contribution" within the meaning of Article 1.1(a)(1)(ii) of the SCM Agreement;
>
> (b) whether the Panel erred in finding, in paragraphs 8.75 and 9.1(a) of the Panel Report, that the ETI measure includes subsidies "contingent ... upon export performance" within the meaning of Article 3.1(a) of the SCM Agreement;
>
> (c) whether the Panel erred in finding, in paragraphs 8.107 and 9.1(a) of the Panel Report that the ETI measure, viewed as a whole, does not fall within the scope of footnote 59 of the SCM Agreement as a measure taken to avoid the double taxation of foreign-source income;

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30. The relevant activities are: (i) advertising and sales promotion; (ii) processing of customer orders and arranging for delivery; (iii) transportation outside the United States in connection with delivery to the customer; (iv) determination and transmittal of final invoice or statement of account or the receipt of payment; and (v) assumption of credit risk. A taxpayer will be treated as having satisfied the foreign economic process requirement when at least 50 percent of the total costs attributable to such activities is attributable to activities performed outside the United States, or, for at least two of these five categories of activity, when at least 85 percent of the total costs attributable to such category of activity is attributable to activities performed outside the United States. (Section 3 of the ETI Act, Section 942(b)(2)(A)(ii), (b)(2)(B) and (b)(3) IRC)

(d) whether the Panel erred in finding, in paragraphs 8.122 and 9.1(c) of the Panel Report, that the ETI measure involves export subsidies inconsistent with the United States' obligations under Articles 3.3, 8 and 10.1 of the Agreement on Agriculture;

(e) whether the Panel erred in finding, in paragraphs 8.158 and 9.1(d) of the Panel Report, that the ETI measure is inconsistent with the United States' obligations under Article III:4 of the GATT 1994 because it accords less favourable treatment to imported products as compared with like products of United States origin;

(f) whether the Panel erred in finding, in paragraphs 8.170 and 9.1(e) of the Panel Report, that the United States has not fully withdrawn the subsidies found, in US - FSC, to be prohibited export subsidies under Article 3.1(a) of the SCM Agreement, and in finding that the United States has, therefore, failed to implement the recommendations and rulings of the DSB made pursuant to Article 4.7 of the SCM Agreement; and

(g) whether the Panel erred in its interpretation of Article 10.3 of the DSU in declining, in its decision of 21 February 2001, reproduced in paragraph 6.3 of the Panel Report, to rule that all the written submissions of the parties filed prior to the only meeting of the Panel must be provided to the third parties.

V. Article 1.1 of the SCM Agreement: "Foregoing Revenue" that is "Otherwise Due"

81. The Panel found that the ETI measure "results in the foregoing of revenue which is 'otherwise due' and thus gives rise to a financial contribution within the meaning of Article 1.1(a)(1)(ii) of the SCM Agreement."

82. In appealing this finding, the United States asserts that the Panel misinterpreted and misapplied the applicable legal standard under Article 1.1(a)(1)(ii), and also mischaracterized the relevant provisions of the IRC. The United States argues that the Panel failed to apply properly the appropriate comparison, as outlined by the Appellate Body in US - FSC, which involves comparing a contested tax measure against a "prevailing domestic standard". According to the United States, the ETI measure establishes a general rule of United States taxation whereby the income excluded from taxation is "outside U.S. taxing jurisdiction". The United States emphasizes that the ETI measure involves the allocation of income from certain foreign sales transactions according to its source. The allocation of such income into domestic and foreign portions, it states, is "a longstanding normative principle of our system of taxation." The United States argues that the ETI measure reformulates the method by which the United States implements this principle, although still in a manner that is consistent with this principle. In this connection, the United States mentions that, traditionally, it has permitted the foreign portion of income from certain foreign sales transactions to be allocated outside the United States' taxing jurisdiction, and excluded from tax, through the use of a foreign-incorporated subsidiary of a United States taxpayer.

83. Furthermore, according to the United States, a Member may exclude from taxation a category of income, consistently with the SCM Agreement, even if it does not exclude all of the income in that category. The United States contends that when a particular category of income is excluded from taxation, a Member may choose to exclude, for revenue and other policy considerations, only a portion of that category of income.

84. The United States also contends that the Panel erred in its identification of the relevant domestic standard because it misconstrued the concept of "gross income" and ignored other provisions of the IRC that are relevant to this dispute. Consequently, the Panel erred in finding that, in the absence of the ETI measure, extraterritorial income would be "gross income" and would be taxed. According to the United States, under the

IRC, "gross income" is the starting point for calculating taxable income, but "gross income" by itself is not necessarily subject to tax because a taxpayer can make "deductions " from it. The Panel thus erred in determining that the prevailing rule of taxation in the United States is that "gross income" is taxable.

85. Before turning to examine the Panel's finding under Article 1.1(a)(1)(ii), certain preliminary observations regarding the SCM Agreement and Article 1.1 thereto should be made. Article 1.1 of the SCM Agreement sets out a definition of a "subsidy" for the purposes of that Agreement. Although this definition is central to the applicability and operation of the remaining provisions of the Agreement, Article 1.1 itself does not impose any obligation on Members with respect to the subsidies it defines. It is the provisions of the SCM Agreement which follow Article 1, such as Articles 3 and 5, which impose obligations on Members with respect to subsidies falling within the definition set forth in Article 1.1. As we said in our Report in Canada–Measures Affecting the Export of Civilian Aircraft–Recourse by Brazil to Article 21.5 of the DSU ("Canada–Aircraft (Article 21.5–Brazil)"):

> ... the granting of a subsidy is not, in and of itself, prohibited under the SCM Agreement. Nor does granting a "subsidy", without more, constitute an inconsistency with that Agreement. The universe of subsidies is vast. Not all subsidies are inconsistent with the SCM Agreement. . . .

86. In other words, Article 1.1 of the SCM Agreement does not prohibit a Member from foregoing revenue that is otherwise due under its rules of taxation, even if this also confers a benefit under Article 1.1(b) of the SCM Agreement. However, if a Member's rules of taxation constitute or provide a subsidy under Article 1.1, and this subsidy is specific under Article 2, the Member must abide by the obligations set out in the SCM Agreement with respect to that subsidy, including the obligation not to "grant [] or maintain" any subsidy that is prohibited under Article 3 of the Agreement. It was in this context that we said in our Report in US - FSC, that, in principle, a Member is free not to tax any particular category of income it wishes, even if this results in the grant of a "subsidy" under Article 1.1 of the SCM Agreement, provided that the Member respects its WTO obligations with respect to the subsidy.

87. The issue we examine under Article 1.1 with respect to the disputed measure is, therefore, a threshold issue that, by itself, does not determine whether the United States has acted inconsistently with its obligations under the SCM Agreement. With this in mind, we now turn to examine Article 1.1(a)(1)(ii) of the SCM Agreement. Pursuant to this provision, there is a "financial contribution by a government" where "government revenue that is otherwise due is foregone or not collected". We considered the meaning of this phrase in our Report in US - FSC, where we stated:

> ... the "foregoing" of revenue "otherwise due" implies that less revenue has been raised by the government than would have been raised in a different situation, or, that is, "otherwise". Moreover, the word "foregone" suggests that the government has given up an entitlement to raise revenue that it could "otherwise" have raised. This cannot, however, be an entitlement in the abstract, because governments, in theory, could tax all revenues. There must, therefore, be some defined, normative benchmark against which a comparison can be made between the revenue actually raised and the revenue that would have been raised "otherwise". We, therefore, agree with the Panel that the term "otherwise due" implies some kind of comparison between the revenues due under the contested measure and revenues that would be due in some other situation. We also agree with the Panel that the

> basis of comparison must be the tax rules applied by the Member in question. ... What is "otherwise due", therefore, depends on the rules of taxation that each Member, by its own choice, establishes for itself. . . .

88. There are several elements in this statement that bear repeating. The first is that, under Article 1.1(a)(1)(ii), a "financial contribution" does not arise simply because a government does not raise revenue which it could have raised. It is true that, from a fiscal perspective, where a government chooses not to tax certain income, no revenue is "due" on that income. However, although a government might, in a sense, be said to "forego" revenue in this situation, this alone gives no indication as to whether the revenue foregone was "otherwise due". In other words, the mere fact that revenues are not "due" from a fiscal perspective does not determine that the revenues are or are not "otherwise due" within the meaning of Article 1.1(a)(1)(ii) of the SCM Agreement.

89. A second element which emerges from our earlier Report is that the treaty phrase "otherwise due" implies a comparison with a "defined, normative benchmark". The purpose of this comparison is to distinguish between situations where revenue foregone is "otherwise due" and situations where such revenue is not "otherwise due". As Members, in principle, have the sovereign authority to determine their own rules of taxation, the comparison under Article 1.1(a)(1)(ii) of the SCM Agreement must necessarily be between the rules of taxation contained in the contested measure and other rules of taxation of the Member in question. Such a comparison enables panels and the Appellate Body to reach an objective conclusion, on the basis of the rules of taxation established by a Member, by its own choice, as to whether the contested measure involves the foregoing of revenue that would be due in some other situation or, in the words of the SCM Agreement, "otherwise due".

90. In our Report in US - FSC, we recognized that it may be difficult to identify the appropriate normative benchmark for comparison under Article 1.1(a)(1)(ii) because domestic rules of taxation are varied and complex. In identifying the appropriate benchmark for comparison, panels must obviously ensure that they identify and examine fiscal situations which it is legitimate to compare. In other words, there must be a rational basis for comparing the fiscal treatment of the income subject to the contested measure and the fiscal treatment of certain other income. In general terms, in this comparison, like will be compared with like. For instance, if the measure at issue involves income earned in sales transactions, it might not be appropriate to compare the treatment of this income with employment income.

91. In identifying the normative benchmark, there may be situations where the measure at issue might be described as an "exception" to a "general" rule of taxation. In such situations, it may be possible to apply a "but for" test to examine the fiscal treatment of income absent the contested measure. We do not, however, consider that Article 1.1(a)(1)(ii) always requires panels to identify, with respect to any particular income, the "general" rule of taxation prevailing in a Member. Given the variety and complexity of domestic tax systems, it will usually be very difficult to isolate a "general" rule of taxation and "exceptions" to that "general" rule. Instead, we believe that panels should seek to compare the fiscal treatment of legitimately comparable income to determine whether the contested measure involves the foregoing of revenue which is "otherwise due", in relation to the income in question.

92. In addition, it is important to ensure that the examination under Article 1.1(a)(1)(ii) involves a comparison of the fiscal treatment of the relevant income for taxpayers in comparable situations. For instance, if the measure at issue is concerned

with the taxation of foreign-source income in the hands of a domestic corporation, it might not be appropriate to compare the measure with the fiscal treatment of such income in the hands of a foreign corporation.

93. Against this background, we turn to the ETI measure. This measure lays down rules of taxation for United States citizens and residents, including both natural and legal persons. . . . The ETI measure permits these taxpayers to elect to have the income they earn from certain transactions, involving certain property, taxed according to the rules set forth in the measure. . . .

94. Under the ETI measure, certain income earned by United States citizens and residents through certain relevant transactions, involving QFTP, is known as "extraterritorial income". Section 114(a) IRC excludes extraterritorial income from "gross income" and from the operation of the rules applicable to "gross income" under Sections 61 and 63 IRC. However, Section 114(b) provides that this exclusion of extraterritorial income from gross income applies solely to that portion of extraterritorial income which is defined as "qualifying foreign trade income" ("QFTI"). The amount of QFTI is determined using one of the three formulae set forth in Section 941(a)(1) IRC.

95. . . . Where a taxpayer elects to use the ETI measure, it must give up any tax credits it has obtained through taxation of its income in a foreign jurisdiction that are attributable to the QFTI excluded from taxation.

96. The Panel reached the conclusion that the exclusion of QFTI from gross income means that the measure involves the foregoing of revenue on this portion of income, and also that revenue is otherwise due on this income. The Panel reasoned that United States taxpayers would "ordinarily" be subject to tax on all income earned in transactions covered by the measure and that the measure "effectively carves ... out" certain income from this other, "ordinary", situation of taxation.

97. In examining the Panel's findings, we observe that the United States argues that, under the ETI measure, QFTI is confined to the foreign-source income earned by United States citizens and residents in transactions covered by the measure. For the purposes of reviewing the Panel's findings under Article 1.1(a)(ii) of the SCM Agreement, we will assume, arguendo, without trying to reach any conclusion on the issue at this stage, that the United States correctly characterizes QFTI as foreign-source income. For these purposes, we assume, also arguendo, that the United States correctly maintains that the measure is merely a continuation of the "longstanding" principle of the United States rules of taxation that seeks to allocate income between domestic- and foreign-source income. . . .

99. Under Sections 1 and 11 IRC, the United States imposes tax on the "taxable income" of each United States citizen and resident. According to Section 63(a) IRC, taxable income means "gross income minus the deductions allowed" under the IRC. Under Section 61(a) IRC, gross income means "all income from whatever source derived". (emphasis added) Thus, Sections 61(a) and 63(a) IRC do not distinguish between income depending on whether the income is treated by the United States as domestic- or foreign-source. Rather, these provisions treat "all income from whatever source" in identical fashion so that, in principle, foreign-source gross income of United States' citizens and residents, less allowable deductions, is subject to tax as taxable income.

100. However, where a portion of the taxable income of a United States citizen or resident is subject to tax in a foreign jurisdiction, the United States credits the taxpayer, subject to certain limitations, with the amount of foreign taxes paid or deemed to have been paid by that taxpayer. Thus, the tax payable to the United States is reduced by the

amount of the tax credit. However, the tax credit granted cannot, as a proportion of the tax due, exceed the proportion of total taxable income which foreign-source income makes up.[78] In this situation, where a taxpayer pays taxes in a foreign jurisdiction, the United States treats a proportion of the tax due to the United States as a tax on foreign-source income, and grants a tax credit with respect to that income.

101. In our view, the normative benchmark for determining whether the ETI measure involves the foregoing of revenue otherwise due, under Article 1.1(a)(1)(ii) of the SCM Agreement, is contained in the United States rules of taxation regarding the foreign-source income of United States' citizens or residents, which we have outlined in the preceding paragraph. Thus, we must compare the taxation of foreign-source income under these "other" rules of taxation, with the taxation of QFTI, which the United States also treats as foreign-source income of these same taxpayers.

102. In so doing, there appears to be a marked contrast between the "other rules" of taxation applicable to foreign-source income and the rules of taxation applicable to QFTI. For United States citizens and residents, the United States, in principle, taxes all foreign-source income, subject to permissible deductions, although the United States grants tax credits for foreign taxes paid. However, under the ETI measure, QFTI is definitively excluded from United States taxation.

103. In addition, as we noted above, United States citizens and residents can elect, at their own discretion: either to have certain of their income treated as extraterritorial income under the ETI measure, with the result that a portion will be definitively excluded from taxation as QFTI; or these same taxpayers can elect to have the same income taxed under the "other" rules applicable to foreign-source income, with tax credits being recognized for, at least, a portion of foreign taxes paid. Where the taxpayer elects not to be taxed under the ETI measure, the United States taxes this income under the "other" rules of taxation applicable to foreign-source income. We see this as confirmation that, absent the ETI measure, the United States would tax the income under the "otherwise" applicable rules of taxation we have used as our benchmark.

104. Clearly, a taxpayer may be expected to elect to use the rules of taxation which result in the payment of the lowest amount of tax. Thus, where a taxpayer elects to be taxed under the ETI measure, the amount of tax paid by the taxpayer will very likely be less than the tax which the taxpayer would have paid, on that income, under the rules "otherwise" applicable to foreign-source income, if the taxpayer did not elect to use the ETI measure. This, too, confirms that the United States will forego revenue under the ETI measure that would be "otherwise due".

105. In our view, the definitive exclusion from tax of QFTI, compared with the taxation of other foreign-source income, and coupled with the right of election for taxpayers to use the rules of taxation most favourable to them, means that, under the contested measure, the United States foregoes revenue on QFTI which is otherwise due.

106. For these reasons, we uphold the Panel's finding . . . that through the measure at issue, the United States government foregoes revenue that is otherwise due within the meaning of Article 1.1(a)(1)(ii) of the SCM Agreement, and that the ETI measure, therefore, gives rise to a financial contribution under Article 1.1(a)(1) of that Agreement. In so holding, we observe that our reasons have a different focus from those given by the Panel. In part, this is because, on appeal, the thrust of the United States' arguments

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78. Section 904(a) IRC. We understand this provision to mean that if foreign-source income makes up, for instance, 10 percent of the total taxable income, the amount of the tax credit cannot exceed 10 percent of the total tax due. . . .

has been directed towards the role of the measure in allocating income as either domestic- or foreign-source.

VI. Article 3.1(a) of the SCM Agreement: Export Contingency

107. Before the Panel, the European Communities drew a distinction between two different subsidies it alleged were granted under the ETI measure. The first subsidy which the European Communities identified was what it called the "basic" subsidy, which related to property produced "within the United States"; the second subsidy it identified was what it called the "extended" subsidy which related to property produced "outside the United States". The European Communities argued that both these subsidies are de jure contingent upon export performance.

108. The Panel found that "the Act involves subsidies 'contingent ... upon export performance' by reason of the requirement of 'use outside the United States' and is therefore inconsistent with Article 3.1(a) of the SCM Agreement." This finding does not expressly draw any distinction between property produced "within" the United States and property produced "outside" the United States, nor does it adopt the distinction the European Communities drew between the so-called "basic" and "extended" subsidies. However, this finding must be read in the light of the reasoning which supports it. In the course of that reasoning, the Panel stated:

> ... in relation to US-produced goods, the words of the statute itself make it clear that exporting is a necessary precondition to qualify for the subsidy. In respect of US-produced goods, the existence and amount of the subsidy depends upon the existence of income arising from the exportation of such goods. In relation to US-produced goods, the existence of such income is clearly conditional, or dependent upon, the exportation of such goods from the United States. We are therefore of the view that by necessary implication the scheme is de jure dependent or contingent upon export in relation to US- produced goods. . . .

109. This passage indicates that the Panel's finding under Article 3.1(a) of the SCM Agreement addressed only the alleged export contingency of the measure "in relation to" property produced "within" the United States and the Panel concluded that, in respect of this property, the grant of the subsidy is contingent upon export performance. . . . The Panel's finding did not also address the alleged export contingency of the measure in relation to property produced "outside" the United States. In other words, the Panel examined the European Communities' claim concerning the "basic" subsidy, but not the claim regarding the "extended" subsidy.[84]

110. The United States appeals the Panel's finding that the measure involves the grant of a subsidy "contingent ... upon export performance". The United States contends that, under Article 3.1(a) of the SCM Agreement, export contingency is a necessary condition of grant if a subsidy is to be export contingent. It points out that the ETI measure is export-neutral as the tax exclusion is available with respect to property that is not produced in the United States and, therefore, not exported from the United States. Thus, it is argued, the tax exclusion can be obtained without exportation so that export performance is not a condition that must be satisfied in order to obtain this exclusion.

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84. . . . The European Communities filed a conditional appeal relating to the Panel's failure to examine the "extended" subsidy. . . . [Ultimately, the Appellate Body did not find it necessary to take up the conditional appeal.]

The Panel, however, overlooked this fact and "artificially bifurcat[ed]" the ETI measure, examining it only as it relates to property produced in the United States. The United States insists that no such distinction exists under the ETI measure.

111. We start with the text of Article 3.1(a) of the SCM Agreement, which provides that "subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance" are prohibited. We have considered this provision in several previous appeals.[86] In Canada - Aircraft, we said that the key word in Article 3.1(a) is "contingent", which means "conditional" or "dependent for its existence on something else". In other words, the grant of the subsidy must be conditional or dependent upon export performance. Footnote 4 of the SCM Agreement, attached to Article 3.1(a), describes the relationship of contingency by stating that the grant of a subsidy must be "tied to" export performance. Article 3.1(a) further provides that such export contingency may be the "sole[]" condition governing the grant of a prohibited subsidy or it may be "one of several other conditions".

112. The Panel found that the measure involves de jure export contingency in relation to property produced in the United States and the United States appeals this finding. We recall that in Canada - Autos, we stated:

> ... a subsidy is contingent "in law" upon export performance when the existence of that condition can be demonstrated on the basis of the very words of the relevant legislation, regulation or other legal instrument constituting the measure. ... [F]or a subsidy to be de jure export contingent, the underlying legal instrument does not always have to provide *expressis verbis* that the subsidy is available only upon fulfillment of the condition of export performance. Such conditionality can also be derived by necessary implication from the words actually used in the measure.

113. Under the ETI measure, the United States excludes from tax a portion of the income earned by United States citizens and residents through certain transactions involving, or related to, QFTP. We recall that Section 943(a)(1)(A) IRC defines QFTP, inter alia, as property "manufactured, produced, grown, or extracted within or outside the United States". . . . The ETI measure, therefore, contemplates two different factual situations, one involving property produced within the United States and the other involving property produced outside the United States. The distinctiveness of these two situations is confirmed by the presence of two provisions in the IRC, each addressing one of these factual situations. Section 943(a)(2) IRC contains rules that apply only to property produced "outside the United States", while Section 943(c) IRC has source rules that address only the case of property produced "within the United States".

114. In respect of property produced within the United States, the taxpayer can obtain the subsidy only by satisfying the conditions in the measure relating to this property and, for this property, the measure provides only one set of conditions governing the grant of subsidy. The conditions for the grant of subsidy with respect to property produced outside the United States are distinct from those governing the grant of subsidy in respect of property produced within the United States.

115. In our view, it is hence appropriate, indeed necessary, under Article 3.1(a) of the

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86. Appellate Body Report, Canada - Measures Affecting the Export of Civilian Aircraft ("Canada - Aircraft "), WT/DS70/AB/R, adopted 20 August 1999, paras. 162-180; Appellate Body Report, US - FSC, supra, . . . paras. 96-121; Appellate Body Report, Canada - Autos, supra, . . . paras. 95-117; Appellate Body Report, Canada - Aircraft (Article 21.5 - Brazil), supra, . . . paras. 25-52.

SCM Agreement, to examine separately the conditions pertaining to the grant of the subsidy in the two different situations addressed by the measure. We find it difficult to accept the United States' arguments that such examination involves an "artificial bifurcation" of the measure. The measure itself identifies the two situations which must be different since the very same property cannot be produced both within and outside the United States.

116. We turn to examine the conditions in the measure governing the grant of the subsidy for property produced within the United States. In its definition of QFTP, the measure provides that, in order to obtain the subsidy, this property must be "held primarily for sale, lease, or rental, in the ordinary course of trade or business for direct use, consumption, or disposition outside the United States ...". For property produced within the United States, this condition means that, for income to be eligible for the fiscal subsidy, the property must be exported. In other words, use outside the United States necessarily implies exportation of the property from the United States (the place of production) to the place of use.

117. At the oral hearing, we inquired of the United States whether, for property produced within the United States, such property must be exported from the United States in order to satisfy the condition of "direct use ... outside the United States". The United States confirmed that such property must be exported to satisfy this condition. For this property, then, the requirement of use outside the United States makes the grant of the tax benefit contingent upon export.

118. It may also be recalled that the measure at issue in the original proceedings in US - FSC contained an almost identical condition relating to "direct use ... outside the United States" for property produced in the United States.[92] In that appeal, we upheld the panel's finding that the combination of the requirements to produce property in the United States and use it outside the United States gave rise to export contingency under Article 3.1(a) of the SCM Agreement. We see no reason, in this appeal, to reach a conclusion different from our conclusion in the original proceedings, namely that there is export contingency, under Article 3.1(a), where the grant of a subsidy is conditioned upon a requirement that property produced in the United States be used outside the United States. . . .

120. For these reasons, we uphold the Panel's finding, . . . which is limited to property "manufactured, produced, grown, or extracted" within the United States-that the measure at issue grants subsidies contingent in law upon export performance within the meaning of Article 3.1(a) of the SCM Agreement. . . .

VII. Footnote 59 to the SCM Agreement: Avoiding Double Taxation of Foreign-Source Income

121. The United States asserted, before the Panel, that, even if the Act involved

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92. Under the FSC measure, qualifying property had to be produced in the United States by a person other than an FSC, and it had to be held primarily for sale, lease, or rental, in the ordinary course of trade or business by, or to, an FSC for direct use, consumption, or disposition outside the United States. (Section 927(a)(1)(A) and (B), now repealed by the ETI Act) Under Section 943(a)(1)(B), inserted into the IRC by Section 3 of the ETI Act, a United States citizen or resident producing property within the United States must hold this property "primarily for sale, lease, or rental, in the ordinary course of trade or business outside the United States." Thus, the only difference between the provisions at issue in the original proceedings and those at issue in these proceedings, relating to property produced in the United States, is that the FSC measure provided that the FSC could not produce the qualifying property, but that it had to be the seller or lessor, whereas the ETI measure does not state who must produce the qualifying property or who must sell it. This difference between the provisions has no bearing on the export contingency of the respective measures.

export contingent subsidies, these subsidies would not be prohibited because of the fifth sentence of footnote 59 to the SCM Agreement, which is attached to item (e) of the Illustrative List of Export Subsidies in Annex I of that Agreement (the "Illustrative List"). . . .

123. In examining the United States' arguments under footnote 59, the Panel found that the term "foreign-source income" refers "to certain income susceptible to 'double taxation'." The Panel observed that a measure need not avoid double taxation of foreign-source income with "precision", nor need it avoid double taxation "entirely" or "exclusively". Nonetheless, the Panel said, "the relationship between the measure and its asserted purpose–i.e. 'to avoid the double taxation of foreign-source income ...'–must be reasonably discernible." The Panel examined the relationship between the measure and its asserted purpose by reviewing "the overall structure, design and operation of the Act". The Panel found that the measure at issue is not taken "to avoid the double taxation of foreign-source income" within the meaning of the fifth sentence of footnote 59 to the SCM Agreement. . . .

125. According to the United States, the fifth sentence of footnote 59 indicates that Members have "broad flexibility in fashioning double taxation relief". It argues that foreign-source income "would appear to include income arising, at least in part, outside the borders or territory of the Member instituting a measure to avoid double taxation" as there is a "possibility of double taxation" of such income. The United States points to the legislative history of the ETI Act to establish that the measure was taken to avoid double taxation within the meaning of footnote 59. The United States maintains that measures to avoid double taxation, under footnote 59, need not be "comprehensive or all-encompassing." . . .

132. The import of the fifth sentence of footnote 59 is that Members are entitled to "take", or "adopt" measures to avoid double taxation of foreign-source income, notwithstanding that they may be, in principle, export subsidies within the meaning of Article 3.1(a). The fifth sentence of footnote 59, therefore, constitutes an exception to the legal regime applicable to export subsidies under Article 3.1(a) by explicitly providing that when a measure is taken to avoid the double taxation of foreign-source income, a Member is entitled to adopt it.

133. Accordingly, as we indicated in US - FSC, the fifth sentence of footnote 59 constitutes an affirmative defence that justifies a prohibited export subsidy when the measure in question is taken "to avoid the double taxation of foreign-source income". In such a situation, the burden of proving that a measure is justified by falling within the scope of the fifth sentence of footnote 59 rests upon the responding party.

134. We, therefore, uphold the Panel's finding . . . that, in this case, the burden of proof under the fifth sentence of footnote 59 falls on the United States.

135. We turn to the United States' appeal that the Panel erred in finding that the ETI measure is not one taken to avoid the double taxation of foreign-source income under footnote 59 to the SCM Agreement. . . .

137. We note at the outset that "double taxation" occurs when the same income, in the hands of the same taxpayer, is liable to tax in different States. The fifth sentence of footnote 59 applies to a measure taken by a Member to avoid such double taxation of "foreign-source income". In examining the phrase "foreign-source income", we observe that, in ordinary usage, the word "source" can refer to the place where a thing originates, and that the words "source" and "origin" can be synonyms. We consider, therefore, that the word "source", in the context of the fifth sentence of footnote 59, has a meaning akin to "origin" and refers to the place where the income is earned. This reading is supported

by the combination of the words "foreign" and "source" as "foreign" also refers to the place where the income is earned. Used in this way, the word "foreign" indicates a source which is external to the Member adopting the measure at stake. Footnote 59, therefore, applies to measures taken by a Member to avoid the double taxation of income earned by a taxpayer of that Member in a "foreign" State.

138. The fifth sentence of footnote 59 to the SCM Agreement permits a Member to take measures granting special fiscal treatment to "foreign-source income" in order to alleviate a "double taxation" burden on its taxpayer. Clearly, if the income benefitting from such special treatment could not be taxed twice, in two different States, there would be no double tax burden to alleviate, and hence no justification for permitting an exception to the prohibition on export subsidies. Thus, the term "foreign-source income" in footnote 59 refers to income which is susceptible of being taxed in two States. The Panel took a similar view when it stated that it understood "the term 'foreign-source income' ... to refer to certain income susceptible to 'double taxation' ".

139. It is, however, no easy matter to determine in every situation when income is susceptible of being taxed in two different States and, thus, when a Member may properly regard income as "foreign-source income". We have emphasized in previous appeals that Members have the sovereign authority to determine their own rules of taxation, provided that they respect their WTO obligations.[116] Thus, subject to this important proviso, each Member is free to determine the rules it will use to identify the source of income and the fiscal consequences–to tax or not to tax the income–flowing from the identification of source. We see nothing in footnote 59 to the SCM Agreement which is intended to alter this situation. We, therefore, agree with the Panel that footnote 59 does not oblige Members to adopt any particular legal standard to determine whether income is foreign-source for the purposes of their double taxation-avoidance measures.

140. At the same time, however, footnote 59 does not give Members an unfettered discretion to avoid double taxation of "foreign-source income" through the grant of export subsidies. As the fifth sentence of footnote 59 to the SCM Agreement constitutes an exception to the prohibition on export subsidies, great care must be taken in defining its scope. If footnote 59 were interpreted to allow a Member to grant a fiscal preference for any income that a Member chooses to regard as foreign-source, that reading would seriously undermine the prohibition on export subsidies in the SCM Agreement. That would allow Members, relying on whatever source rules they adopt, to grant fiscal export subsidies for income that may not actually be susceptible of being taxed in two jurisdictions. Accordingly, the term "foreign-source income", as used in footnote 59 cannot be interpreted by reference solely to the rules of the Member taking the measure to avoid double taxation of foreign-source income.

141. Although there is no universally agreed meaning for the term "foreign-source income" in international tax law, we observe that many States have adopted bilateral or multilateral treaties to address double taxation. The United States, for instance, has more than fifty bilateral tax treaties addressing double taxation. Frequently, bilateral tax treaties have been based on multilaterally developed model tax conventions dealing with double taxation. In addition, the respective member States of the Andean Community and of the Caribbean Community have adopted multilateral agreements, binding on the

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116. See Appellate Body Report, Japan - Taxes on Alcoholic Beverages ("Japan - Alcoholic Beverages II "), WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97, at 110; Appellate Body Report, Chile - Taxes on Alcoholic Beverages, WT/DS87/AB/R, WT/DS110/AB/R, adopted 12 January 2000, paras. 59-60; and Appellate Body Report, US - FSC, supra, . . . para. 90.

members of each community, that seek to avoid double taxation.

142. Although these instruments do not define "foreign-source income" uniformly, it appears to us that certain widely recognized principles of taxation emerge from them. In seeking to give meaning to the term "foreign-source income" in footnote 59 to the SCM Agreement, which is a tax- related provision in an international trade treaty, we believe that it is appropriate for us to derive assistance from these widely recognized principles which many States generally apply in the field of taxation. In identifying these principles, we bear in mind that the measure at issue seeks to address foreign-source income of United States citizens and residents–that is, income earned by these taxpayers in "foreign" States where the taxpayers are not resident.

143. We recognize, of course, that the detailed rules on taxation of non-residents differ considerably from State-to-State, with some States applying rules which may be more likely to tax the income of non-residents than the rules applied by other States. However, despite the differences, there seems to us to be a widely accepted common element to these rules. The common element is that a "foreign" State will tax a non-resident on income which is generated by activities of the non-resident that have some link with that State. Thus, whether a "foreign" State decides to tax non-residents on income generated by a permanent establishment or whether, absent such an establishment, it decides to tax a non-resident on income generated by the conduct of a trade or business on its territory, the "foreign" State taxes a non-resident only on income generated by activities linked to the territory of that State. As a result of this link, the "foreign" State treats the income in question as domestic-source, under its source rules, and taxes it. Conversely, where the income of a non-resident does not have any links with a "foreign" State, it is widely accepted that the income will be subject to tax only in the taxpayer's State of residence, and that this income will not be subject to taxation by a "foreign" State.

144. . . . [N]one [of the participants] has suggested that a non-resident will be taxed in a "foreign" State on income generated by activities that are not, in any way, linked to that "foreign" State. Indeed, the United States argues that QFTI is foreign-source income because this portion of extraterritorial income has "sufficient foreign contacts ... [such] that the transaction may be subject to tax in [a] foreign nation." . . . According to the United States, these "foreign contacts" are established, under the measure, through the performance of the activities described in the foreign economic processes requirement under Section 942(b) IRC. Thus, the United States accepts that "foreign-source income" in footnote 59 is income generated by economic activities that have "sufficient contacts" with a "foreign" State.

145. Accordingly, in our view, "foreign-source income", in footnote 59 to the SCM Agreement, refers to income generated by activities of a non-resident taxpayer in a "foreign" State which have such links with that State so that the income could properly be subject to tax in that State.

146. In view of the divergence in the detailed rules applied by States when taxing non-residents, there will be many situations where some States tax the income of a non-resident, while other States would consider that there was an inadequate link to justify the imposition of tax on non-residents. Thus, from the perspective of the State of residence, there will not be certainty as to when the income of its taxpayers will be subject to tax in a "foreign" State. Despite this uncertainty, one of the widely recognized methods of avoiding double taxation is the tax exemption method. Under this method, States may exempt income from taxation to avoid double taxation, irrespective of whether or not another State taxes the exempt income. The avoidance of double taxation

is not an exact science. Indeed, the income exempted from taxation in the State of residence of the taxpayer might not be subject to a corresponding, or any, tax in a "foreign" State. Yet, this does not necessarily mean that the measure is not taken to avoid double taxation of foreign-source income. Thus, we agree with the Panel, and the United States, that measures falling under footnote 59 are not required to be perfectly tailored to the actual double tax burden.

147. However, the fact that measures falling under footnote 59 to the SCM Agreement may grant a tax exemption even for income that is not taxed in another jurisdiction does not mean that such tax exemptions may be granted, under the fifth sentence of footnote 59, for any income. Footnote 59 prescribes that the income benefitting from a double taxation-avoidance measure must be "foreign-source" and, as we have said, that means that the income must have links with a "foreign" State such that it could properly be subjected to tax in that State, as well as in the Member taking the double taxation-avoidance measure. . . .

149. We turn once more to the ETI measure and recall that footnote 59 to the SCM Agreement applies to measures "tak[en] ... to avoid the double taxation of foreign-source income ...". Like the Panel, we will scrutinize the design, structure and architecture of the contested measure to determine whether it falls within footnote 59.

150. We recall that the United States points to the legislative history of the measure. According to certain passages from that legislative history, "the exclusion of ... extraterritorial income is a means of avoiding double taxation". The legislative history also states that the measure was adopted "to comply with decisions of a World Trade Organization dispute panel and Appellate Body." . . .

151. It is clear to us that the measure addresses situations where United States citizens and residents have engaged in certain economic activities in a "foreign" State. We note that a taxpayer will be treated as having foreign trading gross receipts, which give rise to exempt QFTI, only if the transaction generating these receipts satisfied the "foreign economic process requirement" in Section 942(b) IRC.

152. Under this requirement, certain aspects of the transaction must take place outside the United States. First, the taxpayer must have "participated outside the United States" in one of the following activities: the "solicitation", "negotiation" or "making" of the contract, other than participation in advertising. Second, at least 50 percent of certain of the transaction costs must be attributable "to activities performed outside the United States." The relevant costs are those pertaining to the following five categories of activity: "advertising and sales promotion"; "the processing of customer orders and the arranging for delivery"; "transportation outside the United States in connection with delivery to the customer"; "the determination and transmittal of a final invoice or statement of account or the receipt of payment"; and, "the assumption of credit risk".

153. The foreign economic process requirement focuses on activities of the taxpayer in respect of making and executing the sale or lease of the qualifying property. While we agree with the European Communities that the measure addresses only a limited range of economic activities, we also agree with the United States that these activities occur in a "foreign" State, as they must take place outside the United States. It is, therefore, clear to us that the foreign economic process requirement establishes a link between some part of the qualifying transactions covered by the ETI measure and a "foreign" State.

154. However, the fact that a transaction involves some foreign element, such as the "foreign economic process", does not necessarily mean that all of the income generated by such a transaction will be "foreign-source income" within the meaning of footnote

59 to the SCM Agreement. The sale or lease of property may give rise to taxable income attributable to a variety of activities, of which only some may occur in a "foreign" State. Thus, a sale or lease transaction may give rise to income attributable to activities such as research and development, manufacturing, advertising, selling, transport, and administration. In our view, under footnote 59 to the SCM Agreement, the "foreign-source income" arising in such a transaction is only that portion of the total income which is generated by and properly attributable to activities that do occur in a "foreign" State. Conversely, the portion of the total income generated by and properly attributable to activities that occur within the State of residence is domestic-source income in that State. Thus, where sales or lease income combines domestic- and foreign-source income, not all of the income is foreign-source, just as not all of the income is domestic-source.

155. Under Section 942(a)(1) IRC, "foreign trading gross receipts" are the entirety of the receipts earned by the taxpayer in transactions covered by the measure. "Extraterritorial income" is defined in Section 114(e) IRC as the gross income attributable to foreign trading gross receipts of the taxpayer. "Foreign trade income" is defined in Section 941(b)(1) IRC as the (net) taxable income attributable to foreign trading gross receipts of the taxpayer. Under the ETI measure, as we read the statutory provisions, all of the receipts from a qualifying transaction involving qualifying property are treated as foreign trading gross receipts; all of the gross income earned in such a transaction is treated as extraterritorial income; and all of the (net) taxable income earned in such transaction is treated as foreign trade income.

156. We said earlier that the exempt income under the measure is only QFTI and that the amount of QFTI is calculated, at the choice of the taxpayer, using one of three different formulae set forth in Section 941(a)(1) IRC. Under one of these formulae, the amount of QFTI is equal to 15 percent of the (net) foreign trade income of the taxpayer (the "15 percent rule"), while under a second, QFTI is equal to 1.2 percent of foreign trading gross receipts (the "1.2 percent rule"). Thus, under these two formulae, QFTI is a fixed percentage of either the net amount or the gross amount of all of the income earned by the taxpayer in any qualifying transaction. Under these formulae, QFTI, therefore, includes a percentage of the income earned by the taxpayer from the activities that, cumulatively, generated the totality of the income. In other words, in calculating QFTI under these formulae, the measure does not purport to distinguish, except on an "rule of thumb" basis, between domestic- and foreign-source income according to whether activities generating the income occurred in the United States or in a "foreign State". Instead, QFTI is a fixed percentage of an amount that bundles together both domestic- and foreign-source income.

157. This may be illustrated by way of examples which are based on an example of the operation of the measure given in the United States' House Report. The first example involves two separate sales transactions. We assume that a United States corporation manufactures property in the United States and sells it to an unrelated distributor in the United States, without satisfying the foreign economic process requirement. We assume that the sales price was $80, generating $30 of profit for the manufacturer. At the oral hearing, the United States confirmed that, in such a transaction, the manufacturer will have no extraterritorial income and no QFTI. All of the $30 profit will be gross income under Section 61(a) IRC. We next assume that the same distributor sells this same property to a foreign buyer, for use outside the United States, in a transaction satisfying the foreign economic process requirement. The sales price is $100, generating $20 of profit. At the oral hearing, the United States confirmed that the distributor will have $20 of extraterritorial income and, assuming this is all taxable income, the QFTI will equal

$3 using the 15 percent rule in Section 941(a)(1)C) IRC.

158. In this first example, the manufacturer made $30 of profit and the distributor $20. Of this total of $50 of profit, only the distributor's $20 of profit is extraterritorial income. The exempt QFTI is a portion of distributor's sales and distribution profits, and does not include any profits made by the manufacturer. The United States explained that the 15 percent rule is intended to allocate the sales and distribution income earned in a transaction, in this example by the distributor, between the domestic portion (85%), and the foreign portion attributable to the activities involved in completing the foreign economic process (15%). Thus, the $3 of QFTI is the amount the United States treats as exempt foreign-source income in this example, with the remaining $47 treated as United States domestic-source income.

159. Our second example is taken directly from the House Report itself, and uses the figures given in that Report. It involves precisely the same transactions as our first example, with the same sales prices and profits for the manufacturer and distributor. However, in this case the manufacturer and distributor are related parties. By virtue of Section 942(b)(4) IRC, the manufacturer is deemed to have satisfied the foreign economic process requirement in its transaction with the related distributor because the distributor satisfied this requirement in the subsequent transaction with the foreign buyer. In other words, because the manufacturer and distributor are related, the measure deems the foreign economic process requirement to have been met in the sales transaction between the related parties, when, in fact, it was not met. At the oral hearing, the United States confirmed what is stated in the House Report, namely that as a result of the "deeming" provision in Section 942(b)(4) IRC, the manufacturer's $30 of profit is treated as extraterritorial income and, assuming this is all taxable income, the manufacturer's QFTI will equal $4.50 using the 15 percent rule in Section 941(a)(1)(C) IRC. The distributor will also still have $3 of QFTI. Thus, the related parties have a total of $7.50 of exempt QFTI, which the United States regards as foreign-source income. The remaining $42.50 of profit is treated as domestic-source income. . . .

160. The third example involves only one transaction: the direct sale, by a United States corporation, of property which that corporation manufactured in the United States, to an unrelated foreign buyer for use outside the United States. In this example, we assume that the transaction satisfies the foreign economic process requirement. We assume also that the sales price was $100, generating $50 of profit for the manufacturer. Thus, like the last two examples, the total profit from all activities is $50. However, unlike the last two examples, the entire $50 profit is earned by the manufacturer. At the oral hearing, the United States confirmed that, in this example, the manufacturer will have $50 of extraterritorial income and, again assuming that this is all taxable income, it will have $7.50 of QFTI using the 15 percent rule. The United States argues that the $7.50 represents foreign-source income of the manufacturer, while the remaining $42.50 is taxed in the United States as domestic-source income.

161. The differences in tax treatment among these three examples are revealing. In each example, precisely the same total amount of profit ($50) is earned from precisely the same activities (manufacture, sales and distribution). Moreover, the nature and extent of the foreign-based activities are identical in each example. Yet, in these examples, the allocation between domestic- and foreign-source income that arises from the application of the ETI measure is very different. Indeed, in the second and third examples, the amount of income treated as exempt foreign-source income is more than twice the amount of such income in the first example. . . .

164. We note that our examples, like the one in the House Report, calculate QFTI

using the 15 percent rule. However, if the taxpayer elected to calculate QFTI using the 1.2 percent rule, similar anomalies in the allocation of income as either domestic- or foreign-source would arise. Under this formula also, QFTI would be a portion of the combined domestic- and foreign-source income earned through the cumulation of activities that generated the foreign trading gross receipts of which 1.2 percent is QFTI.

165. . . . Although the ETI measure ensures that transactions giving rise to exempt QFTI have some link with a "foreign" State, . . . two of the measure's allocation rules . . . do not distinguish, on a proper basis, between income generated by activities that occur in the United States and income from activities that occur elsewhere. Rather, under these two rules, QFTI is a fixed portion of all of the income earned by the taxpayer in relevant transactions, including income generated by activities that occur in the United States, such as manufacturing income in our examples. As we have said, income generated by activities that do not have a link with a "foreign" State is not properly regarded as "foreign-source income" within the meaning of footnote 59, but as domestic-source income.

166. Accordingly, in our view, in the calculation of QFTI using the 1.2 and 15 percent rules set forth in Section 941(a)(1)(B) and (C) IRC, the ETI measure fails to distinguish between income which can give rise to foreign-source income–that is, sales and distribution income attributable to the foreign economic processes–and income which cannot, such as income attributable to United States' manufacturing activities. As a result, under these two formulae, the ETI measure improperly combines domestic-source income and foreign-source income in the calculation of QFTI. We, therefore, consider that, when taxpayers elect to use either of these two formulae, the ETI measure results systematically in a misallocation of domestic- and foreign-source income.

167. Furthermore, as we saw in the second example, through Section 942(b)(4) IRC, related parties are able to "sweep into" the calculation of QFTI income from purely domestic transactions, involving in that example domestic-source manufacturing income. In the absence of this provision, the separate transactions between the manufacturer and related distributor, and between the distributor and unrelated foreign buyer, would have operated as a means of separating out some domestic- and foreign-source income in these separate transactions. In other words, the domestic-source income in the first transaction would not be included in the calculation of QFTI. However, the result of the deeming provision in Section 942(b)(4) IRC is to misallocate domestic-source income from the first transaction as foreign-source income.

168. Finally, with respect to the two formulae we have just examined . . . we note that the last sentence of this provision states that the amount determined under the 1.2 percent rule shall in no case exceed 200 percent of the amount determined under the 15 percent rule. This last sentence of Section 941(a)(1) suggests to us that there could be situations where the QFTI claimed by a taxpayer under the 1.2 percent rule could be as much as 200 percent of the QFTI computed for the same transactions under the 15 percent rule. This reinforces our view that the approach embodied in the ETI measure can lead to very different allocations of income between domestic-and foreign-source in respect of precisely the same transaction. This implies to us that the different formulae for calculating QFTI result in a misallocation of income as between the domestic- and foreign-source and, through the election which the taxpayer can make between these formulae, allows the taxpayer to obtain the maximum benefit from the misallocation.

169. The third and final formula for calculating QFTI addresses "foreign sales and leasing income" ("FSLI") and is set forth in Section 941(c)(1) IRC. This provision states that QFTI may be 30 percent of the taxpayer's FSLI. The definition of FSLI contains

some noteworthy differences from the allocation rules under the two formulae we have just examined. Whereas the first two formulae base the calculation of QFTI on combined domestic- and foreign-source income, in contrast, the definition of FSLI . . . is limited to the "foreign trade income properly allocable to activities" that are "performed ... outside the United States" in satisfaction of the foreign economic process requirement. . . .

170. Thus, under this third formula, FSLI is a portion of foreign trade income . . . "properly allocable" to foreign sales and distribution activities. We note that, although the IRC does not define the words "properly allocable", the Senate and House Reports indicate that those words limit FSLI to foreign trade income "associated with sales activities" described in the foreign economic process requirement. We envisage that the application of such a rule requires the taxpayer to establish that, in fact, the "alloca[tion]" made is, indeed, "proper". Interpreted in this way, FSLI is not the entirety of the taxpayers' sales and leasing income, but is only the portion "properly allocable" or attributable to foreign activities. By requiring such a process of separating domestic- and foreign-source income, on the basis of the locus of the activities generating the income, Section 941(a)(1)(A) IRC includes in the calculation of FSLI only income which may properly be regarded as "foreign-source income" under footnote 59 of the SCM Agreement. In other words, Section 941(c)(1)(A) IRC separates out, or unbundles, the domestic- and foreign-source income that are combined in foreign trade income.

171. We note, however, that rules on "proper alloca[tion]" in Section 941(c)(1)(A) IRC do not apply to income derived from the lease or rental of QFTP. In the case of income derived from the "lease or rental" of QFTP, FSLI is simply the "foreign trade income" derived from these transactions. We recall that foreign trade income bundles together domestic- and foreign-source income, in other words, the process of separating domestic- and foreign-source income that we consider is contemplated by the words "properly allocable" does not apply to FSLI which is lease or rental income.

172. However, the provisions relating to FSLI include "special rules for leased property" in Section 941(c)(2) IRC for the calculation of foreign trade income. These special rules apply in two situations. First, where qualifying property is leased by the manufacturer and, second, where qualifying property which has been leased is sold by the manufacturer. In these two situations, FSLI is determined as if the manufacturer had acquired the property from a third party at an arm's length price. . . .

173. We agree that, under the "special rules for leased property", the use of the arm's length rule effects a separation of manufacturing income from all other income. The amount of FSLI is all of the income, less manufacturing income, earned through the lease transaction, or through the sale of leased property. FSLI, therefore, combines or bundles together the remaining income, irrespective of the locus of the activities that generated this income. The remaining FSLI could combine income generated by domestic activities and income generated by foreign activities. As a result the calculation of FSLI for leased property could result in a misallocation of domestic-source income as foreign-source income.

174. To our minds, the inclusion of certain restrictions in calculating FSLI . . . makes all the more striking the omission of any such restrictions where QFTI is calculated using the other two formulae. . . . We find it particularly incongruous that one part of the ETI measure expressly requires a "proper alloca[tion]" of foreign-source income, on the basis of activities "performed ... outside the United States", while the remainder of the measure does not. We also find it noteworthy that, in one part of the ETI measure, a restriction is included specifically "to prevent" an exemption being granted to "profit

associated with manufacturing activities"–which activities will often take place within the United States–while under the 1.2 percent and 15 percent rules no such limitation is provided to exclude domestic-source manufacturing income.

175. We turn now to two other aspects of the ETI measure which we consider similarly result in domestic-source income being treated as exempt foreign-source income. First, for taxpayers with declared foreign trading gross receipts of up to $5,000,000, Section 942(c)(1) IRC dispenses entirely with the foreign economic process requirement. Thus, a portion of the taxpayers' income is treated as exempt foreign-source income even though it has not been established–and need not be established–that the taxpayer undertook any activities outside the United States. However, in the absence of an established link between the income of such taxpayers and their activities in a "foreign" State, we do not believe that there is "foreign-source income" within the meaning of footnote 59 of the SCM Agreement.

176. The United States argued, at the oral hearing, that, in the case of "small" taxpayers with foreign trading gross receipts of only up to $5,000,000, the burden under the foreign economic process requirement is too great to justify imposing this requirement. At the oral hearing, the United States also asserted that, where the exception in Section 942(c)(1) IRC applies, there is in any event a link with a foreign State because, in these cases, the qualifying property in the transaction must be used outside the United States. In our view, however, sales income cannot be regarded as "foreign-source income", under footnote 59, for the sole reason that the property, subject-matter of the sale, is exported to another State, for use there. The mere fact that the buyer uses property outside the United States does not mean that the seller undertook activities in a "foreign" State generating income there. Such an interpretation of footnote 59 would, in effect, allow Members to grant a tax exemption in favour of export-related income on the ground that the exportation by itself of the property renders the income "foreign-source". In our view, this reading would allow Members easily to evade the prohibition on export subsidies in Article 3.1(a) of the SCM Agreement and render this prohibition meaningless.

177. Accordingly, where and to the extent that the "$5,000,000"exception in Section 942(c)(1) IRC applies, the measure grants a tax exemption in favour of income which is not demonstrated to be "foreign-source income" within the meaning of footnote 59 to the SCM Agreement. Rather, this income remains domestic-source.

178. Second, the measure treats domestic-source income as exempt foreign-source income in connection with the performance of services "related and subsidiary" to the sale or lease of qualifying property under Section 942(a)(1)(C) IRC. Under this provision, the performance of certain services in connection with qualifying property, for example repair or maintenance services, can generate foreign trading gross receipts and, hence, exempt QFTI.

179. The IRC does not state expressly that these subsidiary and related service activities need to be performed outside the United States. We note that the rules contained in the Code of Federal Regulations, which applied to the FSC legislation, continue to apply to the provisions of the measure regarding foreign trading gross receipts. According to these regulations, subsidiary and related services "may be performed within or without the United States." . . .

180. The measure, in conjunction with these regulations, therefore, exempts QFTI derived by a United States citizen or resident from the performance of services within the United States. The activities which generate the services income may occur entirely in the United States. In our view, such income has no link with any "foreign" State

which could lead to that State taxing the income and therefore, is not "foreign-source income" within the meaning of footnote 59 to the SCM Agreement. Rather it is domestic-source income.

181. There is one final aspect of the measure to be highlighted. The measure provides rules that exempt a portion of income as QFTI so as to avoid, the United States argues, the double taxation of foreign-source income. The measure does not, however, displace the rules the United States otherwise applies to avoid the double taxation of foreign-source income. These other rules involve the grant of tax credits with respect to foreign-source income on which the taxpayer has paid tax in a "foreign" State. Both the ETI measure and these rules continue to be available, and taxpayers with foreign trading gross receipts under the ETI measure have a choice, on a transaction-by-transaction basis, to opt either for an exemption of a portion of their income as QFTI or to have the income taxed under the other rules with tax credits granted to offset the taxes due in the United States. Moreover, if a taxpayer elects to have income from a transaction taxed under the ETI measure, the taxpayer also has a choice as to the formula to be used to calculate the amount of QFTI. . . .

183. Under the ETI measure, the taxpayer can obtain a tax exemption even for income that is domestic-source income. The taxpayer will not have foreign tax credits with respect to this domestic-source income. In these circumstances, with no tax credits to surrender, the taxpayer would very likely opt for an exemption under the ETI measure of income that includes domestic-source income. The measure operates, in these circumstances, as a means to provide export subsidies for income earned from domestic activities. Correspondingly, the greater the amount of genuine "foreign-source income" included in QFTI, the more likely it is that the taxpayer will have tax credits to give up, and the less likely it becomes that the ETI measure will be used by the taxpayer.

184. In conclusion, our examination discloses that the measure at issue is an extremely complex instrument. We set out to review whether the measure was "tak[en] ... to avoid the double taxation of foreign-source income" within the meaning of footnote 59 to the SCM Agreement. The ETI measure, viewed as a whole, does not permit us to conclude that this measure exempts only "foreign-source income". Rather, in some situations, the ETI measure exempts QFTI which is foreign-source income; in other situations, the ETI measure exempts QFTI which is not foreign-source; and, in yet other situations, the measure exempts QFTI which is a combination of both domestic- and foreign-source income. . . .

186. For these reasons, even though parts of the ETI measure may be regarded as granting a tax exemption for foreign-source income, we find that the United States has not met its burden of proving that the ETI measure, viewed as a whole, falls within the justification available under the fifth sentence of footnote 59 of the SCM Agreement. Accordingly, we uphold the Panel's finding . . . .

VIII. Article 10.1 of the Agreement on Agriculture: Export Subsidies

187. The United States appeals the Panel's finding that:

> ... the United States has acted inconsistently with its obligations under Article 10.1 of the Agreement on Agriculture by applying the export subsidies, with respect to both scheduled and unscheduled agricultural products, in a manner that, at the very least, threatens to circumvent its export subsidy commitments under Article 3.3 of the Agreement on Agriculture.

188. The Panel reached this conclusion because it considered that its reasoning under the SCM Agreement was "also applicable as regards whether the Act gives rise to subsidies contingent upon export performance within the meaning of Article 1(e) of the Agreement on Agriculture for the purposes of Article 10.1 of the Agreement on Agriculture."

189. The United States argues that the ETI measure does not involve export subsidies under Article 1(e) of the Agreement on Agriculture because the measure is not a prohibited export subsidy under Article 3.1(a) of the SCM Agreement. For this reason alone, the United States contends that the Panel erred in finding that the United States had acted inconsistently with its obligations under Articles 10.1 and 8 of the Agreement on Agriculture.

190. Before addressing the ETI measure we consider it useful to recall our findings regarding the FSC measure in our Report in US - FSC. In that Report, we held that, under the Agreement on Agriculture, just as in cases under Article 1.1(a)(1)(ii) of the SCM Agreement, a subsidy may arise where a government foregoes revenues that are otherwise due. In that Report, the reasons which led us to hold, under the SCM Agreement, that the FSC measure involved the foregoing of revenue otherwise due, also led us to the same conclusion under the Agreement on Agriculture.

191. In its appeal in the original proceedings, the United States did not contest that, if the FSC measure involved a "benefit" under Article 1.1(b) of the SCM Agreement, it also involved a benefit under the Agreement on Agriculture. We reached the conclusion that the FSC measure "confer[red] upon the recipient the obvious benefit of reduced tax liability and, therefore, reduced tax payments". Accordingly, we found that the measure involved a subsidy under the Agreement on Agriculture.

192. We held, in US - FSC, that there was no reason to read the requirement of "contingent upon export performance" differently in the SCM Agreement and in the Agreement on Agriculture. Therefore, for the reasons that led us to conclude, under Article 3.1(a) of the SCM Agreement, that this subsidy was contingent upon export performance, we reached the same conclusion under the Agreement on Agriculture.

193. In consequence, we held that the FSC measure involved "subsidies contingent upon export performance" under Article 1(e) of the Agreement on Agriculture. As these subsidies had not been found to be listed in Article 9.1 of the Agreement on Agriculture, we examined whether they were inconsistent with Article 10.1 of that Agreement, as the European Communities claimed. We held that the subsidies were inconsistent with this provision.

194. In this appeal, the United States contends that the measure is not an export subsidy under Article 1(e) of the Agreement on Agriculture because, it argues, the measure is not an export subsidy under Article 3.1(a) of the SCM Agreement. We have rejected the United States' appeal regarding the proper characterization of the measure under Article 3.1(a) of the SCM Agreement. The Panel held, and we have upheld, that the measure involves the foregoing of revenues that are otherwise due under Article 1.1(a)(ii) of the SCM Agreement. As we indicated in US - FSC, where a government foregoes revenues that are otherwise due in relation to agricultural products, a subsidy may arise under the Agreement on Agriculture. The fiscal treatment of agricultural products, under the measure, is not materially different from the fiscal treatment of products falling within the scope of the SCM Agreement. Accordingly, we see no reason to reach any conclusion under the Agreement on Agriculture that differs from our conclusion under the SCM Agreement. The ETI measure also reduces the liability of United States citizens and residents to pay tax on income earned from qualifying

transactions involving agricultural products.

195. In addition, for the reasons we have given in Part VI of this Report with respect to Article 3.1(a) of the SCM Agreement, the measure makes the grant of subsidies "contingent ... upon export performance" where qualifying property is produced within the United States. We can see no reason to conclude otherwise under Article 1(e) of the Agreement on Agriculture, and none has been suggested to us. We, therefore, find that the measure also involves subsidies contingent upon export performance under Article 1(e) of the Agreement on Agriculture.

196. For these reasons, we uphold the Panel's finding that the measure involves export subsidies under Article 1(e) of the Agreement on Agriculture with respect to qualifying property produced within the United States. We also uphold the Panel's finding . . . that the United States acted inconsistently with Articles 10.1 and 8 of the Agreement on Agriculture.

IX. Article III:4 of the GATT 1994

197. Before the Panel, the European Communities challenged the consistency with Article III:4 of the GATT 1994 of Section 943(a)(1)(C) IRC, which establishes, as one of the conditions of eligibility for the tax benefits under the ETI measure, that not more than 50 percent of the fair market value of qualifying property be attributable to articles produced or direct labour performed outside the United States (the "foreign articles/labour limitation" or "fair market value rule").

198. The Panel found that:

> ... by reason of the foreign articles/labour limitation, the Act accords less favourable treatment within the meaning of Article III:4 of the GATT 1994 to imported products than to like products of US origin ...

199. This finding was based on the following three findings by the Panel: (i) that the imported and domestic products at issue are "like products"; (ii) that the measure is a "law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use"; and (iii) that, by conferring an advantage upon the use of domestic products but not upon the use of imported products, the measure accords less favourable treatment to imported products in relation to like products of United States origin.

200. In its appeal under Article III:4 of the GATT 1994, the United States does not challenge the Panel's finding on "like products". Rather, the United States confines its appeal to the Panel's findings: that the measure is a "law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use"; and that the measure provides "less favourable treatment" to imported products as compared with like products of United States origin. . . .

201. We note that the issues arising under Article III:4 of the GATT 1994 relate to the definition of "QFTP" in the measure, in particular the following requirement, which is contained in Section 943(a)(1)(C) IRC:

> (C) not more than 50 per cent of the fair market value of [Qualifying Foreign Trade Property may be] attributable to -
>
> (i) articles manufactured, produced, grown, or extracted outside the United States, and

(ii) direct costs for labour ... performed outside the United States.[176]

202. The European Communities' claim under Article III:4 of the GATT 1994, and the Panel's examination of the ETI Act, concern Section 943(a)(1)(C) solely as it relates to the production of qualifying property within the United States. We recall that, in examining export contingency under Article 3.1(a) of the SCM Agreement, we considered the ETI measure solely in relation to the conditions governing the grant of the subsidy for qualifying property produced within the United States. We do not, therefore, see that the Panel committed any error of law in adopting the same approach in its examination of the claim under Article III:4 of the GATT 1994. . . .

204. Article III:4 is one of a series of provisions in Article III which set forth obligations regarding "National Treatment on Internal Taxation and Regulation". In previous appeals, we have stated that:

> The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. More specifically, the purpose of Article III "is to ensure that internal measures 'not be applied to imported and domestic products so as to afford protection to domestic production"'. Toward this end, Article III obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products. ... Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products.[177] (footnotes omitted)

205. We have also stated that, although this "general principle" is not explicitly invoked in Article III:4, nevertheless, it "informs" that provision.[178] In interpreting Article III:4 we are, therefore, guided by this principle.

206. With these general considerations in mind, we turn to the two issues raised by the United States in its appeal under Article III:4 of the GATT 1994.

A. Law, Regulation or Requirement Affecting the Internal Use of Imported and Like Domestic Products

207. The United States contests the Panel's finding that the measure "affects" the internal use of like imported products, and argues that there is no "necessary relationship" between the fair market value rule and the internal use of imported products. The United States emphasizes that the fair market value rule is a "measure of general application that is not directed against imports". In such a situation, the United States argues, the word "affecting" in Article III:4 must be given a narrow scope. However, the United States does not contest the Panel's finding that the fair market value rule is a "law, regulation or requirement" within the meaning of Article III:4 of the GATT 1994.

208. We observe that the clause in which the word "affecting" appears–"in respect of all laws, regulations and requirements affecting their internal sale, offering for sale,

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176. We refer to this provision as the "fair market value rule"; the Panel termed it the "foreign articles/labour limitation".

177. Appellate Body Report, Japan - Alcoholic Beverages II, supra, footnote 116, at 109-110, quoting from Panel Report, United States - Section 337 of the Tariff Act of 1930, adopted 7 November 1989, BISD 36S/345, para. 5.10. We cited this statement in Appellate Body Report, European Communities - Measures Affecting Asbestos and Asbestos-Containing Products ("EC - Asbestos "), WT/DS135/AB/R, adopted 5 April 2001, para. 97, a dispute that also involved Article III:4 of the GATT 1994.

178. Appellate Body Report, EC - Asbestos, supra, footnote 177, para. 98.

purchase, transportation, distribution or use"–serves to define the scope of application of Article III:4. . . . Within this phrase, the word "affecting" operates as a link between identified types of government action ("laws, regulations and requirements") and specific transactions, activities and uses relating to products in the marketplace ("internal sale, offering for sale, purchase, transportation, distribution or use"). It is, therefore, not any "laws, regulations and requirements" which are covered by Article III:4, but only those which "affect" the specific transactions, activities and uses mentioned in that provision. Thus, the word "affecting" assists in defining the types of measure that must conform to the obligation not to accord "less favourable treatment" to like imported products, which is set out in Article III:4.

209. The word "affecting" serves a similar function in Article I:1 of the General Agreement on Trade in Services (the "GATS"), where it also defines the types of measure that are subject to the disciplines set forth elsewhere in the GATS but does not, in itself, impose any obligation. In EC - Bananas III, we considered the meaning of the word "affecting" in that provision of GATS. We stated:

> [t]he ordinary meaning of the word "affecting" implies a measure that has "an effect on", which indicates a broad scope of application. This interpretation is further reinforced by the conclusions of previous panels that the term "affecting" in the context of Article III of the GATT is wider in scope than such terms as "regulating" or "governing". . . .

210. In view of the similar function of the identical word, "affecting", in Article III:4 of the GATT 1994, we also interpret this word, in this provision, as having a "broad scope of application".

211. Turning to the fair market value rule, we recall that, under the ETI measure, a taxpayer producing property in the United States will be eligible to obtain a tax exemption in respect of income derived from an export-sale of such property on the condition that, inter alia, not more than 50 percent of the fair market value of the product is attributable to articles produced outside the United States or to direct costs for labour performed outside the United States. The United States regards the fair market value of property as the sales price of the property in the marketplace. Fair market value is attributable to three different elements: (i) inputs used to produce the property; (ii) direct labour used to produce the property, and (iii) "non- tangible elements, including intellectual property rights, goodwill, capital, marketing, distribution, and other services".

212. Any taxpayer that seeks to obtain a tax exemption under the ETI measure must ensure that, in the manufacture of qualifying property, it does not "use" imported input products, whose value comprises more than 50 percent of the fair market value of the end-product. The fair market value rule, thus, places an express maximum limit on the extent to which the value of qualifying property can be attributable to imported input products. A manufacturer's use of imported input products always counts against the 50 percent ceiling in the fair market value rule, while in contrast, the same manufacturer's use of like domestic input products has no such negative implication. Manufacturers wishing to obtain the ETI tax exemption are not restricted, in any way, on the use they make of domestic inputs. The fair market value rule, therefore, influences the manufacturer's choice between like imported and domestic input products if it wishes to obtain the tax exemption under the ETI measure.

213. Accordingly, we agree with the Panel's finding . . . that the fair market value rule "affects" the "internal ... use" of imported products, within the meaning of Article III:4

of the GATT 1994, as compared with like domestic products.

B. "Less Favourable Treatment"

214. We now come to the second part of the United States' appeal of this issue, namely, its argument that the Panel erred in finding that the fair market value rule accords less favourable treatment to like imported products. The United States asserts that it is possible for a manufacturer to satisfy the fair market value rule without using as inputs any goods produced in the United States, and that the Panel could not, therefore, have found that the fair market value rule involves de jure discrimination against imports.

215. The examination of whether a measure involves "less favourable treatment" of imported products within the meaning of Article III:4 of the GATT 1994 must be grounded in close scrutiny of the "fundamental thrust and effect of the measure itself".[183] This examination cannot rest on simple assertion, but must be founded on a careful analysis of the contested measure and of its implications in the marketplace. At the same time, however, the examination need not be based on the actual effects of the contested measure in the marketplace.[184]

216. If a United States citizen or resident fulfills the prescribed conditions of grant, it obtains a clearly significant financial benefit in the form of a tax exemption. The availability of such a tax exemption depends upon the taxpayer organizing its business affairs in such a way as to comply with the prescribed conditions of grant.

217. One of these conditions is the fair market value rule which places, as we have said, an express maximum limit on the extent to which the value of qualifying property can be attributable to imported input products. No such limit exists for like domestic input products. The fair market value rule, therefore, draws a formal distinction, on its face, between the treatment of like domestic and imported input products. This formal difference also has substantive importance because, on its face, the fair market value rule constrains the use of like imported input products.

218. In situations where the use of imported input products in the manufacture of qualifying property may breach the 50 percent limit and thereby render a manufacturer ineligible to obtain a tax exemption, the manufacturer will avoid the use of like imported input products if it wishes to obtain a tax exemption. As the 50 percent limit is approached, the manufacturer will be increasingly sensitive to the value of the imported input products it can use and to the contribution these products will make to the fair market value of the property being manufactured. Before making purchasing decisions, the manufacturer will weigh the choice between domestic and imported input product, in the light of the anticipated value of the end-product, to ensure that the purchases of imported products do not adversely affect the availability of the tax exemption. These same considerations will never apply if the manufacturer opts to purchase domestic input products. Thus, for purposes of satisfying the fair market value rule and ensuring the availability of the tax benefit, a real and substantive advantage attaches to the use of domestic input products, and a corresponding disadvantage to the use of like imported products.

219. The difference in resulting treatment between like domestic and imported

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183. Appellate Body Report, Korea - Various Measures on Beef, [WT/DS161/AB/R, WT/DS169/AB/R, adopted 10 January 2001], para. 142.

184. Appellate Body Report, Japan - Alcoholic Beverages II, supra, footnote 116, at 110.

products becomes very clear where the manufacturing process is product input-intensive and the value of input products typically constitutes more than 50 percent of the fair market value of the qualifying property. In these situations, the measure in effect precludes United States manufacturers who desire the tax benefit, from making a free choice between like domestic and imported input-products on the basis of purely commercial considerations.

220. In sum, if the manufacturer wishes to obtain the beneficial tax exemption under the ETI measure, the fair market value rule provides a considerable impetus, and, in some circumstances, in effect, a requirement, for manufacturers to use domestic input products, rather than like imported ones. As such, the fair market value rule treats imported products less favourably than like domestic products.

221. In our view, the above conclusion is not nullified by the fact that the fair market value rule will not give rise to less favourable treatment for like imported products in each and every case. There may well be, as the United States maintains, property which does not require extensive material and labour inputs such that the fair market value rule would not, in those cases, bear upon the input choices manufacturers make. Even so, the fact remains that in an indefinite number of other cases, the fair market value rule operates, by its terms, as a significant constraint upon the use of imported input products. We are not entitled to disregard that fact.

222. For the above reasons, we uphold the Panel's finding . . . that, by virtue of the fair market value rule, the measure accords less favourable treatment within the meaning of Article III:4 of the GATT 1994 to imported products than to like products of United States origin.

X. Article 4.7 of the SCM Agreement: Withdrawal of FSC Subsidies

223. The United States appeals the Panel's finding that:

> ... the United States has not fully withdrawn the FSC subsidies found to be prohibited export subsidies inconsistent with Article 3.1(a) of the SCM Agreement and has therefore failed to implement the recommendations and rulings of the DSB made pursuant to Article 4.7 SCM Agreement.

224. The United States notes that the ETI Act repeals the FSC provisions and provides that no corporation can elect to be treated as an FSC after 30 September 2000. The ETI Act also contains certain transitional rules that, in the view of the United States, ensure taxpayers a degree of certainty in their tax planning and that are essential to the orderly passage from one set of tax rules to another. The United States submits that, in requiring a Member to change its tax rules, WTO rules cannot be intended to require such a Member to deny its taxpayers the right to an orderly transition. Thus, the United States reasons, the Panel's finding that the United States has acted inconsistently with Article 4.7 of the SCM Agreement should be reversed.

225. We recall that, in our Report in US - FSC, we upheld the panel's finding "that the FSC measure constitutes a prohibited export subsidy under Article 3.1(a) of the SCM Agreement". In its report, the panel recommended, pursuant to Article 4.7 of the SCM Agreement, that the United States withdraw the FSC subsidies found to be prohibited export subsidies under Article 3.1(a) of the SCM Agreement by 1 October 2000". On 12 October 2000, the DSB acceded to the United States' request "that the DSB modify the time-period in this dispute so as to expire on 1 November 2000". ...

227. In examining this provision in Brazil - Aircraft (Article 21.5 - Canada), we said:

> Turning to the ordinary meaning of "withdraw", we observe first that this word has been defined as "remove" or "take away" , and as "to take away what has been enjoyed; to take from." This definition suggests that "withdrawal" of a subsidy, under Article 4.7 of the SCM Agreement, refers to the "removal" or "taking away" of that subsidy. (footnotes omitted)

228. Under the ETI Act, no corporation may elect to be treated as an FSC after 30 September 2000. However, for FSCs in existence as of that date, the repeal of the original FSC measure "shall not apply" to any transaction which occurs before 1 January 2002. Moreover, even after that date, existing FSCs can continue to use the original FSC measure for transactions pursuant to a binding contract between the FSC and any unrelated person that was in effect on and after 30 September 2000. Thus, by the United States' own acknowledgement, the original FSC measure continues to apply, unmodified, to existing FSCs in respect of a defined set of transactions. The success of the United States' appeal depends on the success of its argument that prohibited FSC subsidies can continue to be granted to protect the contractual interests of private parties and to ensure an orderly transition to the regime of the new measure. In short, on the basis of these arguments, the United States seeks to have the time-period for the full withdrawal of the prohibited FSC subsidies extended, in some circumstances, indefinitely.

229. Article 4.7 of the SCM Agreement requires prohibited subsidies to be withdrawn "without delay", and provides that a time-period for such withdrawal shall be specified by the panel. We can see no basis in Article 4.7 of the SCM Agreement for extending the time-period prescribed for withdrawal of prohibited subsidies for the reasons cited by the United States. In that respect, we recall that, in Brazil - Aircraft (Article 21.5 - Canada), Brazil made a similar argument to the one made by the United States in these proceedings. Brazil argued that, after the expiration of the time-period for withdrawal of the prohibited export subsidies, it should be permitted to continue to grant certain of these subsidies because it had assumed contractual obligations, under municipal law, to do so. We rejected this argument, and observed that:

> ... to continue to make payments under an export subsidy measure found to be prohibited is not consistent with the obligation to "withdraw" prohibited export subsidies, in the sense of "removing" or "taking away".

230. Thus, as we indicated in that appeal, a Member's obligation under Article 4.7 of the SCM Agreement to withdraw prohibited subsidies "without delay" isunaffected by contractual obligations that the Member itself may have assumed under municipal law. Likewise, a Member's obligation to withdraw prohibited export subsidies, under Article 4.7 of the SCM Agreement, cannot be affected by contractual obligations which private parties may have assumed inter se in reliance on laws conferring prohibited export subsidies. Accordingly, we see no legal basis for extending the time-period for the United States to withdraw fully the prohibited FSC subsidies.

231. Accordingly, we uphold the Panel's finding, in paragraphs 8.170 and 9.1(e) of its Report, that the United States has not fully withdrawn the FSC subsidies found to be prohibited export subsidies under Article 3.1(a) of the SCM Agreement and has therefore failed to implement the recommendations and rulings of the DSB made

pursuant to Article 4.7 of the SCM Agreement. . . .

NOTES AND QUESTIONS

1. How closely do the tone and argumentation of the Appellate Body's reports in *Canada–Measures* and *United States–Tax Treatment* resemble those of appellate decisions with which you are familiar from within a *domestic* judicial system? Does the Appellate Body seem law- and rule-oriented in its approach? More than some of the early GATT panel reports that we have already read?

2. In these two reports, does the Appellate Body rely on "precedents" and "holdings?" What kind of authorities and what kind of reasoning does it employ in this report? To what extent, if at all, does the Appellate Body seem to consider itself "bound" by anything other than the texts of the international agreements that it is interpreting and applying?

3. In paragraphs 121-134 of the *United States–Tax Treatment* report, the Appellate Body concludes that the United States has the burden of proving that the ETI Act is a permissible tax measure to avoid double taxation. Is its reasoning convincing? How does it compare with the reasoning on this issue in *Canada–Measures*? Is the allocation of the burden of proof a critical issue in this dispute? The Illustrative List of Export Subsidies in Annex I of the SCM Agreement identifies typical prohibited subsidies, including item (e). Couldn't the fifth sentence of footnote 59 to the SCM Agreement be viewed as an *interpretive* provision–rather than an *exception*–limiting the scope of item (e) for purposes of the EU's argument? Would such a view alter the burden of proof?

4. Consider paragraphs 93-106 of the *United States–Tax Treatment* report. Would it have made a difference if the United States had amended its tax laws by (a) repealing the FSC provisions; and, (b) excluding all "foreign-source income" from "gross income" (while also repealing the foreign tax credit provisions)? What would have been the net effect of such an amendment on U.S. tax revenues?

5. What if the hypothetical amendment in the previous question only applied to "foreign-source income" of taxpayers whose products had, in the aggregate, some specified minimum percentage of U.S.-origin inputs? In this regard, consider paragraphs 107-112 of the Appellate Body's report. Would this requirement violate GATT article III? Consider paragraphs 197-222.

6. The Appellate Body pointed out (paragraph 139) that WTO members "have the sovereign authority to determine their own rules of taxation," and it recognized (paragraph 143) that "the detailed rules on taxation of non-residents differ considerably from State-to-State." If so, then how can the Appellate Body identify "widely recognized principles of taxation" with respect to the meaning of the term "foreign-source income" (paragraph 142)? Is there some emerging public international law of international taxation?

7. Review paragraphs 223-231 of the Appellate Body's report. Is the report dealing with an independent violation, or merely applying compliance pressure with respect to a previously adopted report? The ETI Act both repealed and replaced the FSC provisions. What if the repeal portion was enacted first, as a separate piece of legislation? Would that have affected the Appellate Body's reasoning or conclusions as to SCM Agreement article 4.7?

4. Practice and Procedure

Dispute resolution under the DSU follows a legalistic model, rather than a diplomatic or negotiation model. It is markedly more formal and procedurally driven than what one would expect from a reading of GATT Articles XXII and XXIII. The provisions of the DSU itself–together with rules in the Working Procedures adopted under the DSU–provide a very sophisticated procedural framework for the resolution of disputes between and among WTO members.

QUESTIONS

Among the typical kinds of procedural issues that arise are the following:

a. *Framing the issues*. To what extent is the dispute resolution controlled by a panel's terms of reference?

b. *Issue preclusion*. As a matter of fair notice and procedural regularity, to what extent will a claimant or respondent be precluded from raising issues related to the claims before the panel? Before the Appellate Body?

c. *Evidentiary scope and appellate review*. How far is the Appellate Body limited to the factual record and assertions of the parties first raised before the panel?

d. *Concrete disputes v. advisory opinions*. Does the dispute resolution process of the DSU allow for "advisory opinions," as is the practice before some international adjudicatory bodies, or are such opinions beyond the scope of the DSB's authority, as is the practice before U.S. federal courts, which are limited to "cases and controversies"?

In considering these issues, review the following excerpted Appellate Body report.

UNITED STATES–CONTINUED DUMPING AND SUBSIDY OFFSET ACT OF 2000

WT/DS217/AB/R, WT/DS234/AB/R (January 16, 2003)

[For the factual background of the dispute, see the excerpt reproduced in Chapter VI, *supra* at ▬.]

V. Procedural Matters and Ruling

185.. . . Canada, supported by other appellees[91] and one third participant[,Norway], argues that the United States is in breach of Rule 20(2)(d) of the Working Procedures, because the United States' appellant's submission allegedly includes claims, allegations and requests for ruling that were not included in the United States' Notice of Appeal. Canada requests that these claims be struck from the appeal. In addition, Canada objects, with support from other appellees[94] and one third participant[, Norway] to the inclusion in the United States' appellant's submission of arguments that, in Canada's view, impugn certain evidence relied upon by the Panel, and to the inclusion of what Canada regards as new evidence that was not before the Panel. Canada submits that these arguments and the alleged new evidence are outside the scope of appellate review by virtue of Article 17.6 of the DSU.

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91. Australia, Chile, the European Communities, India, Indonesia, Japan, Korea and Thailand join Canada in respect of allegations regarding the non- inclusion of claims under DSU Articles 7, 11 and 12.7. In addition, Brazil joins Canada in respect of allegations regarding the non-inclusion of claims under Article 7 of the DSU.

94. Australia, Chile, the European Communities, India, Indonesia, Japan, Korea and Thailand.

186. Canada requested a preliminary ruling on these issues, to which the United States objected on the grounds that Canada's claims are "meritless" and because neither the DSU nor the Working Procedures permits such rulings. We denied the request for a preliminary ruling without ruling on the substance of the issues. We will address them here in turn.

A. Allegations of Flaws in the Notice of Appeal

187. Canada, supported by other participants, argues that the United States refers in its appellant's submission to four issues that were not included in the Notice of Appeal:

> • the United States' contention . . . that the Panel failed to meet its obligations under Article 11 of the DSU because the Panel did not undertake an objective assessment of the matter before it;
>
> • the United States' contention . . . that the Panel failed to meet its obligations under Article 12.7 of the DSU because the Panel did not explain why it examined the burden that the measure creates on conditions of competition;
>
> • the United States' contention . . . that the Panel exceeded its terms of reference by examining claims concerning the CDSOA "in combination" with other United States laws and regulations; and
>
> • the United States' contention . . . that the Panel exceeded its terms of reference by issuing an "advisory opinion" on a measure that was not before it.

188. Canada submits that these "claims, allegations and requests for ruling" are not properly before us because they were not included in the Notice of Appeal. According to Canada, Rule 20(2)(d) of the Working Procedures "requires a Notice of Appeal to include 'a brief statement of the nature of the appeal, including allegations of errors in the issues of law covered in the panel report and legal interpretations developed by the panel."' Canada argues that these requirements, "as well as the requirements of due process, mandate[ ] the United States to include in its Notice of Appeal all claims of error that the United States intends to raise." Canada submits that "[b]y failing to include any reference to claims that the Panel violated Articles 7, 11 and 12.7 of the DSU, the United States is in breach of these requirements." Canada asserts that these claims of error are very serious allegations that must not be made without proper notification to the appellees in the Notice of Appeal. Finally, Canada requests that the claims with respect to Articles 7, 11 and 12.7 be struck from this appeal.

189. The United States clarified at the oral hearing that it is not requesting a finding that the Panel failed to act consistently with Articles 11 and 12.7 of the DSU. The United States explained that the reference in paragraph 40 of its appellant's submission to the Panel's failure to meet its obligations under Articles 11 and 12.7 of the DSU is merely an argument in support of its claim that the Panel erred in interpreting Article 18.1 of the Anti-Dumping Agreement and Article 32.1 of the SCM Agreement.

190. . . . [T]he United States' appellant's submission refers explicitly to the Panel's failure to meet its obligations under [Articles 11 and 12.7]. The clear implication is that the United States was indeed making claims under Articles 11 and 12.7 of the DSU. We also note that the United States did not suggest in . . . objecting to Canada's request for a preliminary ruling on the scope of appeal, that it was not requesting findings under those provisions. In our view, Canada and the other appellees were therefore justified in interpreting the United States' appellant's submission as if such claims were indeed being made by the United States. However, given the United States' explanation at the oral hearing that it was not pursuing such claims, the issue of whether they were notified in the Notice of Appeal has become moot.

191. We look next to the other two matters raised by Canada and other participants as not being in the Notice of Appeal and hence not properly before us, namely the United States' arguments . . . that the Panel exceeded its terms of reference. The United States contends that its Notice of Appeal is in accordance with Rule 20(2)(d) and relies on our interpretation of that Rule in US-Countervailing Measures on Certain EC Products, where we said:

> The Working Procedures for Appellate Review enjoin the appellant to be brief in its notice of appeal in setting out "the nature of the appeal, including the allegations of errors". We believe that, in principle, the "nature of the appeal" and "the allegations of errors" are sufficiently set out where the notice of appeal adequately identifies the findings or legal interpretations of the Panel which are being appealed as erroneous. The notice of appeal is not expected to contain the reasons why the appellant regards those findings or interpretations as erroneous. The notice of appeal is not designed to be a summary or outline of the arguments to be made by the appellant. The legal arguments in support of the allegations of error are, of course, to be set out and developed in the appellant's submission.

192. According to the United States, its Notice of Appeal "is more than sufficient in setting out the 'findings or legal interpretations of the Panel' from which the United States is appealing." The United States contends that the claims regarding the Panel's exceeding its terms of reference are included in the Notice of Appeal because they fall within the United States' claim set out in the Notice that the Panel erred in its interpretation of Article 18.1 of the Anti-Dumping Agreement and Article 32.1 of the SCM Agreement. In any event, the United States stated at the oral hearing that, as a question of jurisdiction, it is open to the Appellate Body to examine whether a panel exceeded its terms of reference even if no such claim is included in the Notice of Appeal.

193. In examining these submissions, we look first to Rule 20(2) of the Working Procedures, which prescribes what is to be included in the Notice of Appeal. In addition to the title of the panel report under appeal, the name of the appellant, and the service address, paragraph (d) states that a Notice of Appeal shall include:

> ... a brief statement of the nature of the appeal, including the allegations of errors in the issues of law covered in the panel report and legal interpretations developed by the panel.

194. We have examined this provision in previous appeals.[111] Most recently, in US-Countervailing Measures on Certain EC Products, we said:

> [O]ur previous rulings have underscored the important balance that must be maintained between the right of Members to exercise the right of appeal meaningfully and effectively, and the right of appellees to receive notice through the Notice of Appeal of the findings under appeal, so that they may exercise their right of defence effectively. ... [The] requirements under Rule 20(2) serve to ensure that the appellee also receives notice, albeit brief, of the "nature of the appeal" and the "allegations of errors" by the panel.

195. The underlying rationale of Rule 20(2)(d) is thus to require the appellant to provide notice of the claims of error that the appellant intends to argue on appeal.

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111. Appellate Body Report, US-Shrimp, paras. 92-97; Appellate Body Report, EC-Bananas III, paras. 151-152; Appellate Body Report, US-Countervailing Measures on Certain EC Products, paras. 50-75.

196. Turning to the Notice of Appeal filed in this case, the United States maintains that "[e]ach of the U.S. arguments claimed by Canada to be outside the scope of the appeal fall squarely within the matters raised in the first numbered paragraph of the U.S. notice."

197. [I]n Section IV of the United States' appellant's submission, which is entitled "The Panel Exceeded Its Terms of Reference By Examining Claims Concerning The CDSOA In Combination With Other U.S. Laws And Regulations[,]" . . . the United States submits that the Panel exceeded its terms of reference by examining whether the CDSOA, in combination with United States laws on the imposition of anti-dumping duties (or countervailing duties), violate Article 18.1 of the Anti-Dumping Agreement and Article 32.1 of the SCM Agreement. The United States argues that the Panel's terms of reference are limited to examining whether the CDSOA, as such, is WTO-consistent, and do not permit an examination of whether the CDSOA, in combination with any other United States law or regulation, violates United States obligations' under the WTO Agreement.

198. Canada, supported by other appellees[116] and one third participant[, Norway], alleges that Section IV of the United States' appellant's submission relates to a claim as to "the exercise of jurisdiction by the Panel under Article 7 of the DSU", and that such claim was not included in the Notice of Appeal. Canada asks us to exclude this claim from the scope of appeal. The United States responds that "[b]ecause the U.S. notice of appeal covers the Panel's findings and related legal interpretations regarding Antidumping Agreement Article 18.1 and SCM Agreement 13.2 [*sic*], the matters addressed in Section IV are plainly covered by the notice of appeal."

199. A plain reading of the first numbered paragraph of the United States' Notice of Appeal . . . reveals that there is no explicit reference to Article 7 of the DSU. Nor is there any allegation, explicit or implied, that the Panel exceeded its terms of reference with respect to any of its findings. Indeed, no such claim is apparent in any of the paragraphs of the Notice of Appeal.

200. We do not agree with the United States' contention that the first numbered paragraph of the United States' Notice of Appeal . . . "plainly covers" a claim that the Panel exceeded its terms of reference. . . . Generic statements such as that relied upon by the United States cannot serve to give the appellees adequate notice that they will be required to defend against a claim that the Panel exceeded its terms of reference. This is particularly so for procedural errors; it can be especially difficult to discern a claim of procedural error by a panel from general references to panel findings or from extracts of a panel report, because allegations of procedural error by a panel may not necessarily be raised until the appellate stage.

201. Therefore, we agree with Canada and other participants that the Notice of Appeal does not provide adequate notice that a claim that the Panel exceeded its terms of reference in ruling on the CDSOA in combination with other laws would be argued by the United States on appeal.

202. Canada, supported by other appellees[121] and one third participant[, Norway], also challenges the United States' arguments set out in Section VI of the United States' appellant's submission as being outside the scope of appeal because they were not included in the Notice of Appeal. Section VI of the United States' appellant's submission

116. Australia, Brazil, Chile, the European Communities, India, Indonesia, Japan, Korea and Thailand.
121. Australia, Chile, the European Communities, India, Indonesia, Japan, Korea, Mexico and Thailand.

is entitled "The Panel Erred in Issuing an Advisory Opinion on a Measure Outside of Its Terms of Reference." The United States contends in that Section that the Panel rendered an "advisory opinion" by making a finding on a measure that was not before it, when it said:

> Even if CDSOA offset payments were funded directly from the US Treasury, and in an amount unrelated to collected anti-dumping duties, we would still be required to reach the conclusion . . . that offset payments may be made only in situations presenting the constituent elements of dumping.

203. The United States argues that because there was no measure before the Panel regarding payments funded directly from the United States Treasury, the Panel had no authority to make this finding.

204. Canada, supported by other participants, alleges that Section VI . . . relates to a claim as to "the exercise of jurisdiction by the Panel under Article 7 of the DSU", which was not in the Notice of Appeal. Canada requests us to rule that this claim of the United States is outside the scope of appellate review. The United States responds that "[b]ecause the U.S. notice of appeal covers the Panel's findings and related legal interpretations regarding Antidumping Agreement Article 18.1 and SCM Agreement Article 13.2 [*sic*], the matters addressed in Section VI are well within the scope of the notice of appeal."

205. We have already explained that we see no reference, explicit or implicit, in the Notice of Appeal regarding the Panel's exceeding its terms of reference. Therefore, our reasoning above applies equally to the United States' claim regarding the alleged advisory opinion in the Panel Report.

206. Having concluded that the Notice of Appeal does not provide notice to the appellees that the United States intended to make claims that the Panel exceeded its terms of reference, the next question is whether we are precluded from examining these claims on appeal. As we have explained, if an appellee has not received sufficient notice in the Notice of Appeal that a particular claim will be advanced by the appellant, that claim normally will be excluded from the appeal. However, we observe that the United States has argued in this appeal that we are entitled to examine questions of jurisdiction in any event, even if not included in the Notice of Appeal.

207. We agree with the United States' position. We have stated previously, in relation to a panel's obligation to address issues related to its jurisdiction, that:

> ... panels have to address and dispose of certain issues of a fundamental nature, even if the parties to the dispute remain silent on those issues. In this regard, we have previously observed that "[t]he vesting of jurisdiction in a panel is a fundamental prerequisite for lawful panel proceedings." For this reason, panels cannot simply ignore issues which go to the root of their jurisdiction–that is, to their authority to deal with and dispose of matters. Rather, panels must deal with such issues–if necessary, on their own motion–in order to satisfy themselves that they have authority to proceed.[127] (footnote omitted)

208. In our view, the same reasoning applies in this case. As we have said, "[a]n objection to jurisdiction should be raised as early as possible"[128] and it would be

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127. Appellate Body Report, Mexico-Corn Syrup (Article 21.5-US), para. 36.
128. Appellate Body Report, US-1916 Act, para. 54.

preferable, in the interests of due process, for the appellant to raise such issues in the Notice of Appeal, so that appellees will be aware that this claim will be advanced on appeal. However, in our view, the issue of a panel's jurisdiction is so fundamental that it is appropriate to consider claims that a panel has exceeded its jurisdiction even if such claims were not raised in the Notice of Appeal.

209. It is convenient to proceed now with a consideration of the United States' claims that the Panel exceeded its terms of reference "by examining claims concerning the CDSOA in combination with other U.S. laws and regulations" and "in issuing an advisory opinion on a measure outside of its terms of reference."

210. Turning to the first of the United States' contentions, the Panel stated, in connection with its discussion on whether the CDSOA operates "against" dumping or a subsidy, that:

> We agree that dumping over time may be evidence of a competitive advantage. However, the combination of anti-dumping duties and offset subsidies is not merely to level the playing field, but to transfer that competitive advantage to "affected domestic producer".

211. In addition, the Panel said in a footnote:

> Although our finding that the CDSOA constitutes "specific action against dumping" and subsidy rests on the adverse impact of the CDSOA on exporters/foreign producers engaged in dumping, that adverse impact does not result exclusively from the provision of offset payment subsidies (or the use of a subsidy). The adverse impact results from the combination of anti-dumping duties and offset payment subsidies in the particular circumstances of the CDSOA.

212. In our view, these statements do not constitute a finding by the Panel that was outside its terms of reference. The Panel was merely reflecting in its reasoning the fact that the CDSOA does not operate in a vacuum but, rather, operates in a context that includes other laws and regulations. The Panel's view was that the combination of anti-dumping duties (or countervailing duties) and CDSOA offset payments distorts the competitive relationship between dumped (subsidized) and domestic products, to the detriment of dumped (subsidized) products. This led the Panel to find that the CDSOA-alone-has an adverse bearing on dumping (subsidization) and, therefore, operates "against" dumping (subsidies) within the meaning of Article 18.1 of the Anti-Dumping Agreement (and Article 32.1 of the SCM Agreement). Therefore, we dismiss the claim of the United States that the Panel exceeded its terms of reference by examining claims concerning the CDSOA "in combination" with other United States laws and regulations.

213. We turn next to the United States' contention that the Panel erred in issuing an "advisory opinion" on a measure outside of its terms of reference. The United States takes issue with the following statement by the Panel:

> Even if CDSOA offset payments were funded directly from the US Treasury, and in an amount unrelated to collected anti-dumping duties, we would still be required to reach the conclusion - for the reasons set forth in the preceding paragraph - that offset payments may be made only in situations presenting the constituent elements of dumping.

214. We note that the Panel made this observation in response to the United States' argument that the fact that CDSOA distributions are funded by proceeds from

anti-dumping and countervailing duties does not render the CDSOA a "specific action against dumping." The Panel reasoned that, even if the offset payments were funded directly from the United States Treasury, and in an amount unrelated to the collected duties, it would still "reach the conclusion ... that offset payments may be made only in situations presenting the constituent elements of dumping." We do not agree with the United States that, in making this statement, the Panel was making a finding on a matter that was outside the Panel's terms of reference. In our view, the Panel was simply making an observation to make it abundantly clear that its finding was in no way based on the fact that offset payments are funded from collected anti-dumping duties. Therefore, we dismiss the United States' claim that the Panel issued an "advisory opinion" exceeding its terms of reference.[135]

B. Allegations Regarding the Scope of Appellate Review Under Article 17.6 of the DSU

215. We turn next to the second procedural issue raised by Canada, supported by other appellees[137] and one third participant[, Norway], namely the issue whether the United States included arguments and evidence in its appellant's submission that are outside the scope of appellate review by virtue of Article 17.6 of the DSU. Specifically, Canada points to the comments in paragraphs 120 and 121 of the United States' appellant's submission regarding two letters referred to in paragraphs 7.62 and 7.45 of the Panel Report. In addition, Canada contends that footnotes 148 and 149 of the United States' appellant's submission refer to evidence that was not before the Panel.

216. [The Appellate Body quotes DSU Article 17.6.]

1. The United States' Comments About Letters Before the Panel

217. In paragraphs 7.45 and 7.62 of the Panel Report, the Panel refers to a letter from a United States producer which, according to the Panel, demonstrates that that producer changed its position concerning an application after initiation of the investigation, and decided to express support for the application to impose anti-dumping and countervailing duties in order to remain eligible for possible offset payment subsidies. In the same paragraphs, the Panel also referred to a letter from a lawyer dated 8 January 2001, which, according to the Panel, illustrates the potential for the CDSOA to encourage domestic producers to support applications for the imposition of dumping or countervailing duties. The Panel referred to those letters in paragraph 7.62 to support its finding that the United States failed to comply with its obligations under Article 5.4 of the Anti-Dumping Agreement and Article 11.4 of the SCM Agreement (more specifically, as regards the issue that the CDSOA operates as an incentive for domestic producers to support applications for imposition of anti-dumping and countervailing duties). These letters were also cited in paragraph 7.45 in relation to the finding that the CDSOA is contrary to Article 18.1 of the Anti-Dumping Agreement and Article 32.1 of the SCM Agreement (more specifically, as regards the question whether the CDSOA operates "against" dumping or subsidies within the meaning of those provisions).

218. The United States makes the following comments on the letters in paragraphs 120 and 121 of its appellant's submission:

> Moreover, the examination of the letter reveals that the letter is not what the Panel claimed

135. We observe that the concept of "advisory opinion" has a special meaning in the context of international adjudication. A number of international courts and tribunals, including the International Court of Justice and the European Court of Justice, provide in their statutes or rules for the provision of such opinions upon the request of States or of certain authorized bodies.

137. Australia, Chile, the European Communities, India, Indonesia, Japan, Korea and Thailand.

> it to be. It is neither a letter from a "domestic producer" nor a letter changing positions. In fact, the company that authored the letter states therein that it is expressing its "continuing" support for the petitions (i.e., it is not expressing a change in position), citing a letter it submitted to the ITC over a month earlier in which the producer had already expressed support for the petition. Moreover, the company had entered an appearances before the ITC and Commerce as a "foreign manufacturer, producer, or exporter, or the United States importer, of subject merchandise"–not a domestic producer. Thus, the letter is irrelevant to the issue for which the Panel cited it. Contrary to the claim of the Panel, the company did not change its position. (footnotes omitted)
>
> The Panel also cited a letter in which a U.S. producer purportedly urged other domestic producers to support a petition against Canadian softwood lumber imports by citing the CDSOA. Examination of the letter referencing the CDSOA, however, shows that it was not written by a domestic producer, but instead by a law firm informing domestic producers of the merits and circumstances of their case, as well as various provisions of U.S. law including the CDSOA. Importantly, the letter counsels that petitioners/supporters cannot count on obtaining funds under the CDSOA. The letter does not try to use the CDSOA to induce other domestic producers to support a petition. It certainly does not promise CDSOA disbursements if domestic producers support the petition. Furthermore, there is no indication that the letter actually had the effect of influencing any domestic producers to support the petition, much less to support a petition it otherwise would not but for the potential to become eligible for CDSOA offsets.

219. Canada agrees that the two letters referred in paragraphs 120-121 of the United States appellant's submission were in evidence before the Panel. Canada's objection is that the United States is prohibited by virtue of Article 17.6 of the DSU from challenging the "credibility and weight the Panel attached to the two letters." Canada argues that the Panel's statements about the letters did not form part of its legal reasoning. Therefore, according to Canada, we cannot consider the United States' explanations about the nature of the letters because there is "no question of legal characterisation by the Panel of facts before it in respect of the two letters".

220. We do not regard the United States' comments in paragraphs 120-121 as impugning the Panel's factual findings on the two letters. In our view, the United States' comments form part of its challenge to the Panel's legal conclusions that the CDSOA is inconsistent with Article 5.4 of the Anti-Dumping Agreement and Article 11.4 of the SCM Agreement, as well as with Article 18.1 of the Anti-Dumping Agreement and Article 32.1 of the SCM Agreement. Whether such findings are supported by those letters is an issue of law, properly raised by the United States in its Notice of Appeal, on which we have the authority to decide under Article 17.6 of the DSU.

2. Allegations of New Evidence in Footnotes 148 and 149

221. In footnotes 148 and 149 of the United States' appellant's submission, the United States cites various documents in connection with its challenge to the Panel's conclusions about the import of the two letters referred to above, noting that they are "available on the public record". According to Canada, supported by other participants[149] the documents constitute new evidence that was not before the Panel and, consequently, our consideration of that evidence is beyond the scope of appellate review by virtue of Article 17.6 of the DSU.

222. We agree with the submission of Canada. It is not disputed that footnotes 148

149. Australia, Chile, the European Communities, India, Indonesia, Japan, Korea, Norway and Thailand.

and 149 of the United States' appellant's submission refer to documents that were not part of the Panel record. The United States submits that it referred to the documents "to provide the Appellate Body with a greater understanding of the facts involved in the dispute". However, Article 17.6 is clear in limiting our jurisdiction to issues of law covered in panel reports and legal interpretations developed by panels. We have no authority to consider new facts on appeal. The fact that the documents are "available on the public record" does not excuse us from the limitations imposed by Article 17.6. We note that the other participants have not had an opportunity to comment on those documents and, in order to do so, may feel required to adduce yet more evidence. We would also be precluded from considering such evidence. We find, therefore, that the documents referred to in footnotes 148 and 149 of the United States' appellant's submission that were not part of the Panel record, constitute new evidence. Consequently, by virtue of Article 17.6 of the DSU, we are precluded from taking those documents into account in deciding this appeal.

NOTES AND QUESTIONS

1. In *United States–Continued Dumping and Subsidy Offset Act of 2000*, WT/DS217/AB/R, WT/DS234/AB/R (January 16, 2003),[150] Canada and Mexico separately requested the establishment of a panel with respect to the same dispute that had been initiated by nine other WTO members a month before. One month after these separate requests, the DSB agreed to those requests. Pursuant to DSU Article 9.1, it referred the matter to the panel that had already been established to hear the claims of the original nine members.

2. If Article 9.1 allows this sort of consolidation of separate claims, is the panel and/or Appellate Body required to produce *one* report covering *all* claims and claimants? Can the respondent state–here the United States–demand separate reports as to each claimant or claim? In answering these questions, consider the following excerpt.

UNITED STATES–CONTINUED DUMPING AND SUBSIDY OFFSET ACT OF 2000

WT/DS217/AB/R, WT/DS234/AB/R (January 16, 2003)

[For the factual background of the dispute, see the excerpt reproduced in Chapter VI, *supra* at ▬.]

X. Article 9.2 of the DSU

305. The United States claims on appeal that the Panel acted inconsistently with Article 9.2 of the DSU by denying the United States' request for a separate panel report on the dispute brought by Mexico.

306. The Panel took the view that, although Article 9.2 of the DSU provides a general right to WTO Members to request a separate report, such requests "should be made in a timely manner, since any need to prepare separate reports may affect the manner in which a panel organises its proceedings." The Panel added that, in its view, "such requests should be made at an early juncture in the panel process, preferably at the time

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150. For an extended excerpt from the Appellate Body's report concerning the substantive issues in the dispute, see Chapter VI, *supra* at ▬.

that a panel is established." Turning to the case at hand, the Panel observed that "the US request was received on 10 June 2002, approximately two months after issuance of the descriptive part of the Panel's report" and that the United States had provided "no explanation of why it was unable to submit its request at an earlier date". The Panel also noted that the United States had not referred to any prejudice that it would suffer if the Panel were not to issue a separate report on the dispute brought by Mexico.

307. Based on these considerations, the Panel concluded:

> ... that the preparation of a separate report on the dispute brought by Mexico would delay issuance of the Panel's interim report. Although the United States only requested a separate final report, we are not prepared to issue a separate final report without also issuing a separate interim report. This is because we are not entitled to issue a final report on the dispute brought by Mexico without first having issued an interim report on that dispute. Otherwise Mexico would be denied its right to request a review of precise aspects of its interim report (DSU Article 15.2).

Accordingly, the Panel rejected the United States' request. [FN257]

308. The United States appeals this finding of the Panel. The United States submits that Article 9.2 of the DSU gives WTO Members an "unqualified right to the issuance of separate panel reports upon request". According to the United States, Article 9.2 contains no requirement for a party to make its request for a separate panel report by any particular time in the panel proceeding. Nor does it require any party to demonstrate that it would suffer prejudice if its request is not accepted.

309. [The Appellate Body quotes DSU Article 9.2.]

310. By its terms, Article 9.2 accords to the requesting party a broad right to request a separate report. The text of Article 9.2 does not make this right dependent on any conditions. Rather, Article 9.2 explicitly provides that a panel "shall" submit separate reports "if one of the parties to the dispute so requests". Thus the text of Article 9.2 of the DSU contains no requirement for the request for a separate panel report to be made by a certain time. We observe, however, that the text does not explicitly provide that such requests may be made at any time.

311. Having made these observations, we note that Article 9.2 must not be read in isolation from other provisions of the DSU, and without taking into account the overall object and purpose of that Agreement. The overall object and purpose of the DSU is expressed in Article 3.3 of that Agreement which provides, relevantly, that the "prompt settlement" of disputes is "essential to the effective functioning of the WTO." If the right to a separate panel report under Article 9.2 were "unqualified", this would mean that a panel would have the obligation to submit a separate panel report, pursuant to the request of a party to the dispute, at any time during the panel proceedings. Moreover, a request for such a report could be made for whatever reason-or indeed, without any reason-even on the day that immediately precedes the day the panel report is due to be circulated to WTO Members at large. Such an interpretation would clearly undermine the overall object and purpose of the DSU to ensure the "prompt settlement" of disputes.

312. In support of its argument, the United States relied on EC-Bananas III (US) where the panel granted the European Communities' request for "four separate panel reports". We note, however, as did the Panel, that the European Communities' request was made at the meeting at which the DSB established the panel. EC-Bananas III (US) is therefore distinguishable from the present case. Thus, we cannot agree with the United States that the right contained in Article 9.2 is "unqualified".

313. Our view is supported by our decision in US-FSC, where we observed that:

> The procedural rules of WTO dispute settlement are designed to promote ... the fair, prompt and effective resolution of trade disputes.

In the somewhat different context of the time by which procedural objections must be raised, we stated in Mexico-Corn Syrup (Article 21.5-US), that:

> When a Member wishes to raise an objection in dispute settlement proceedings, it is always incumbent on that Member to do so promptly. A Member that fails to raise its objections in a timely manner, notwithstanding one or more opportunities to do so, may be deemed to have waived its right to have a panel consider such objections.[262]

314. In the case at hand, the United States made its request under Article 9.2 "approximately two months after the issuance of the descriptive part of the Panel's report" and more than seven months after the Panel had been composed. It therefore cannot be said that the United States made its request "promptly" or in a "timely manner, notwithstanding one or more opportunities to do so".

315. Finally we note that the first sentence in Article 9.2 provides that it is for the panel to "organize its examination and present its findings in such a manner that the rights which the parties to the dispute would have enjoyed had separate panels examined the complaints are in no way impaired." Our comments in EC-Hormones about panels' discretion in dealing with procedural issues are pertinent here:

> ... the DSU and in particular its Appendix 3, leave panels a margin of discretion to deal, always in accordance with due process, with specific situations that may arise in a particular case and that are not explicitly regulated. Within this context, an appellant requesting the Appellate Body to reverse a panel's ruling on matters of procedure must demonstrate the prejudice generated by such legal ruling.

316. In our view, the Panel acted within its "margin of discretion" by denying the United States' request for a separate panel report. We do not believe that we should lightly disturb panels' decisions on their procedure, particularly in cases such as the one at hand, in which the Panel's decision appears to have been reasonable and in accordance with due process. We observe that, on appeal, the United States is not claiming that it suffered any prejudice from the denial of its request for a separate panel report.[266] We also note that the first sentence of Article 9.2 refers to the rights of all the parties to the dispute. The Panel correctly based its decision on an assessment of the rights of all the parties, and not of one alone.

317. Accordingly, we reject the United States' claim that the Panel acted inconsistently with Article 9.2 of the DSU by not issuing a separate panel report in the dispute

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262. Appellate Body Report, Mexico-Corn Syrup (Article 21.5-US), para. 50. The Appellate Body also emphasized the need for procedural objections to be made in a timely manner in US-1916 Act, para. 54.

266. The United States submits that a showing of prejudice is not required by the text of Article 9.2. In response to questioning at the oral hearing, the United States added that, although it was not aware of any prejudice that it would have suffered in this case, prejudice could have resulted if, for example, Mexico had chosen to cross-appeal the claim related to Article 5 of the SCM Agreement, which only Mexico raised before the Panel.

brought by Mexico.[267]

C. CONTEMPORARY PRACTICE–SECTION 301

Under the Trade Expansion Act of 1962, the Congress granted the President the power to take actions against imports under certain conditions.[1] This statute was replaced and expanded by Title III of the Trade Act of 1974, which granted similar powers to the President in § 301. The Act also established procedures enabling U.S. citizens to petition the government for action against measures by foreign governments. This portion of the Trade Act of 1974 has been amended several times, most notably by the Uruguay Round Agreements Act of 1994.[2] As amended, Title III, entitled "Relief from unfair trade practices," comprises §§ 301-310, but is usually referred to generically as "§ 301." Most of the amendments enacted between 1974 and 1994 were designed to reduce the President's discretion under § 301. The prevailing view in Congress was that the President had not made sufficient use of the powers under the section, because he had given priority to foreign policy concerns over trade interests.

Prior to the 1988 amendments of § 301, it was the President who was authorized to determine whether the foreign government practices were actionable and whether the United States should respond to them with trade measures.[3] Currently, § 301(a) applies to any case in which the USTR determines under § 304(a)(1) that U.S. rights under a trade agreement are being denied, or that an act, policy or practice of a foreign country violates or is inconsistent with the provisions of, or otherwise denies benefits to the United States under, a trade agreement, or is unjustifiable and burdens or restricts United States commerce. § 301(a)(1). On the basis of an investigation under § 302 and consultations (and proceedings, if applicable) under § 303, the USTR is required to determine whether U.S. trade agreement rights are being denied, or whether any specified unfair act, policy, or practice exists. § 304(a)(1).[4]

If the USTR determines that one of these situations has occurred, then the USTR is required to take action as authorized in § 301(c), subject to any specific direction of the President regarding the action, to enforce U.S. rights or to obtain the elimination of the unfair act, policy, or practice. § 301(a). However, action is not required if the DSB adopts a report finding that U.S. rights under a WTO agreement have not been denied, or that the act, policy or practice at issue is not a violation of, or inconsistent with, U.S. rights or does not deny, nullify, or impair benefits to the United States under any trade agreement. § 301(a)(2)(A).

Section 301(a)(2)(B)(i) provides that the USTR is not required to take action if he or

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267. We express no view on the question whether the Panel was correct in concluding, in paragraph 7.5 of the Panel Report, that it was "not entitled to issue a final report on the dispute brought by Mexico without first having issued an interim report on that dispute". In this respect, we note moreover that the United States has not requested a finding with respect to whether the Panel erred in its interpretation of Article 15.2 of the DSU.

1. Trade Expansion Act of 1962, § 252, Pub.L. No. 87-794, 75 Stat. 879.

2. Pub. L. No. 96-39, Title IX, § 901, July 26, 1979, 93 Stat. 295 (revising Title III); Pub. L. No. 98-573, Title III, § 304, Oct. 30, 1984, 98 Stat. 3002; Pub. L. No. 100-418, Title I, § 1301, Aug. 23, 1988, 102 Stat. 1164; Pub. L. No. 103-465, Title III, § 314, Title VI, § 621, Dec. 8, 1994, 108 Stat. 4939; Pub.L. 104-295, § 20, Oct. 11, 1996, 110 Stat. 3528.

3. In reality, however, the USTR serves at the pleasure of the President and will still take guidance from the President. This is thus a less important shift than might appear to be the case. (This reality is underlined by the statute, which permits the President to "direct" the USTR which remedies to take with regard to retaliatory actions. § 301(a)-(b), as amended by § 1301 of the 1988 Act.)

4. How restrictive of the USTR's discretion the requirement in § 304 might be was the subject of considerable disagreement, until the panel decision in *United States–Sections 301-310 of the Trade Act of 1974, infra*.

she finds that the foreign country is taking satisfactory measures to grant the U.S. rights under a trade agreement. Commitment by a WTO Member to implement DSB recommendations favorable to the United States within the period foreseen in Article 21 of the DSB has, for example, been determined by the USTR to be a "satisfactory measure" justifying a termination of the investigation without taking any action under Section 301.[5]

Similarly, under § 301(a)(2)(B)(ii)-(iii), the USTR is not required to take action if the foreign country agrees to (1) the elimination or phasing out of the offending act, policy or practice at issue; (2) an imminent solution to the burden or restriction on U.S. commerce; or, (3) compensatory trade benefits satisfactory to the USTR. In addition, under certain special circumstances, the USTR is not required to take action; namely, (1) in extraordinary cases, when the USTR finds that taking action would have an adverse impact on the U.S. economy substantially out of proportion to the benefits of the action (§ 301(a)(2)(B)(iv)); or, (2) when the USTR finds that taking action would cause serious harm to U.S. national security. § 301(a)(2)(B)(v).

The following examples show § 301 at work, and illustrate the extensive role it has continued to play. The first, involving Canada's refusal to allow an income tax deduction for advertising on United States border radio and television stations, shows the scope of application of the section and the broad range of options available to the president. The second, involving an Argentine limit on cattlehide exports, shows how the section can be used to seek to enforce a trade agreement. And together with the third example, that of steel, it raises the question of whether § 301 should be used when more specific remedies are available. In reading these decisions, consider whether they would be affected by the amendments to § 301 enacted since the early 1980s.

PRESIDENTIAL MEMORANDUM OF JULY 31, 1980 DETERMINATION UNDER SECTION301 OF THE TRADE ACT OF 1974 MEMORANDUM FOR THE UNITED STATES TRADE REPRESENTATIVE

45 Fed. Reg. 51,173 (1980)

Under the provisions of section 301(a)(2) of the Trade Act of 1974 (the Trade Act) (19 U.S.C. 2411(a)(2)), I have determined that the action described below is an appropriate and feasible response to the practice of Canada in denying an income tax deduction to Canadian advertisers who contract with U.S. television and radio broadcasting stations located near the U.S.-Canadian border (border broadcasters) for advertising aimed primarily at the Canadian market.

STATEMENT OF REASONS

The Office of the United States Trade Representative initiated an investigation of September 6, 1978 (43 FR 39617) on the basis of a petition filed on behalf of 15 U.S. television licensees. As is reflected in the legislative history to the Trade Act and

5. *See* 63 Fed. Reg. 56,688 (1998) (terminating original § 301 investigation concerning EC banana regime).

clarified in the amendment to section 301 in the Trade Agreements Act of 1979 (Pub. L. 96-39, Title IX; 93 Stat. 295), authority to act under section 301 extends to cases involving service industries.

Public hearings were conducted at the request of the petitioner on November 29, 1978, and consultations with the Government of Canada took place on August 15, 1979, in Ottawa. Public hearings relating to the remedies suggested by the petitioner were held on July 9, 1980, to provide an opportunity for parties who might be affected by such actions to comment.

After considering the recommendation of the United States Trade Representative and the evidence developed in the investigation and the hearings, I have determined that the Canadian tax practice with respect to advertising placed with U.S. border broadcasters is unreasonable and burdens and restricts U.S. commerce, within the meaning of section 301.

The longstanding business relationships between U.S. border broadcasters and their Canadian advertisers were disrupted by the enactment in Canada of Bill C-58 in 1976. The bill, which became section 19.1 of the Canadian Tax Law, was intended to strengthen the Canadian broadcast industry as an aspect of Canadian culture. However, while some Canadian broadcasters have benefitted from the law, it denies the U.S. border broadcasters access to a substantial portion of the advertising market in Canada, amounting to approximately $20 to $25 million annually, to which they previously had had access. The law, in effect, places the cost of attaining its objectives on U.S. companies and thus unreasonably and unnecessarily burdens and restricts U.S. commerce.

Consultations were held between U.S. and Canadian broadcasters and between the U.S. and Canadian government, in order to seek a solution which would address the Canadian cultural development objective without having an adverse impact upon the U.S. broadcasting stations. These consultations were not successful in finding a basis for the negotiation of a mutually acceptable solution.

I have determined that the most appropriate response to the Canadian practice is to propose legislation to the Congress which, when enacted, would mirror in U.S. law the Canadian practice. This legislation would amend the U.S. Internal Revenue Code to deny income tax deductions for the costs of advertising primarily aimed at U.S. audiences and placed on broadcast stations located in a foreign country if a similar deduction under the income tax law of that country is denied for advertising principally aimed at its audience and placed on U.S. broadcast stations.

This measured response is most appropriate because it is directed at those interests in Canada which now benefit from the denial, resulting from enactment of C-58, of Canadian advertising revenues to U.S. border broadcasters.

The proposed U.S. law itself will apply to Canada only as long as, and to the degree that, the Canadian law applies. No disruption of other, unrelated markets will be created which might have adverse effects in other areas of the U.S. economy. . . .

TANNERS' COUNCIL OF AMERICA, INC.; INITIATION OF INVESTIGATION

46 Fed. Reg. 59,353 (1981)

On October 9, 1981, the Chairman of the Section 301 Committee [Office of the United States Trade Representative] received a petition from the Tanners' Council of

America, Inc. alleging that Argentina has defaulted on its 1979 Agreement with the United States to liberalize access to Argentine hides; that the failure to honor this agreement burdens and restricts U.S. commerce; and that Argentina imposes unreasonable restraints on access to raw cattle hides which impede domestic and third country sales of the U.S. leather tanning industry. The petition was filed pursuant to Section 301 of the Trade Act of 1974, as amended (19 U.S.C. 2411 et seq.). On November 24, 1981, the United States Trade Representative decided to initiate an investigation pursuant to 19 U.S.C. 2412(a).

The text of the petition is as follows:

> [T]he Tanners' Council of America, Inc. charges that Argentina engages in unfair trade practices detrimental to the domestic leather tanning industry. The Tanners' Council of America is a nonprofit trade association that represents virtually the entire U.S. leather tanning industry. The council claims:
>
> (1) Argentina defaulted on its agreement with the United States on leather and hides. This failure to honor this agreement burdens and restricts U.S. commerce.
>
> (2) Argentina imposes unreasonable restraints on access to raw cattlehides which impedes domestic and third country sales of the U.S. leather tanning industry.
>
> These unreasonable Argentine policies and actions are severely damaging to the U.S. leather tanning industry and have contributed to a sharp growth in U.S. imports of leather and a corresponding decline in U.S. tanning production. . . . The Tanners' Council requests a review of the Argentine practices and urges President Reagan to take all appropriate and feasible steps to obtain relief from these unfair trade practices.
>
> Because of the serious nature of the Argentine action–defaulting on an international agreement–the Council urges retaliation under section 301(b), and requests that the President impose restrictions on Argentine leather imports into the U.S.
>
> The Tanners' Council has not filed for other forms of relief available under the Trade Act of 1974 or any other provisions of law. However, since Argentina maintains subsidies on exports of leather, the Council is considering filing countervailing duty action on these practices. The government of Argentina provides two forms of subsidy: A *reembolso* or direct export payment to exporters of leather, and a system of preferential financing to Argentine exporters of leather.

(1) ARGENTINE DEFAULT

In 1979 the U.S. government negotiated an agreement with the government of Argentina to liberalize access to Argentine hides. The United States agreed to grant concessions on imports of Argentine corned beef and cheese and to reduce U.S. tariffs on cattlehide leather. Argentina agreed to remove its ban on cattlehide exports, and to replace it with an export tax which would be reduced to zero in three years.

The U.S. government has honored its commitments under the agreement. However, the government of Argentina has failed to meet its scheduled commitment for April 1981, and is in default.

Argentina's export tax on cattlehides reduces the price of Argentine hides relative to world hide prices. This reduction acts as a subsidy for Argentine exports of cattlehide leather by artificially depressing the price of Argentine raw material.

During the period of time that Argentina was nominally in compliance with the agreement, the Argentine government took another measure which effectively negated part of the concession to which Argentina had agreed. Argentina imposed a minimum export price on cattlehides. This minimum export price was used instead of the transaction price in determining the amount of tax to be charged on export shipments of

hides. Since the minimum export price was higher than the transaction price, the effective tax was higher than that which had been agreed.

The Argentine default has had several detrimental effects on the welfare of the U.S. tanning industry. The failure to comply:

(a) Harms the U.S. industry directly by giving the Argentine leather industry an unfair competitive edge in U.S. and third country markets.

(b) Undermines efforts to liberalize international trade in hides and leather through agreements with other countries.

(c) Signals to the rest of the world that Argentina can default on an agreement in this sector without eliciting effective U.S. response.

(d) Marks a return to protectionist tendencies in the leather and hide sector. Significant achievements of the agreement were a reversal of these trends and the encouragement of the hope that free markets would once again prevail for these products.

(2) ARGENTINA IMPOSES UNREASONABLE RESTRICTIONS ON ACCESS TO RAW CATTLEHIDES

In 1972, in an effort to promote the development of its leather and leather products industries, Argentina banned the export of green salted cattlehides. This ban created a great distortion in the international marketplace. Prices of U.S. cattlehides tripled in the twelve-month period October 1971 to October 1972. . . . The distortions caused by the Argentine restrictions were never completely corrected but exist to this day.

Furthermore, other developing countries followed the Argentine example and restricted access to their hides and skins. This follow-the-leader action increased the burden on U.S. cattlehide supplies. As a result it was estimated that in 1978, out of a world cattle slaughter approaching 300 million head the United States, although slaughtering but 15% of this total, contributed between 70% and 75% of total international trade in cattlehides.

From the U.S. side, the U.S./Argentine agreement had three objectives:

(a) To add Argentine hides to the international pool of raw material supply. This addition would spread the burden of adjustments to changing supply and demand conditions from total dependence on the U.S. and would minimize hide price fluctuations.

(b) To cause Argentine hides to be more price-responsive to international market conditions. This equalization of raw material prices would reduce the Argentines' competitive advantage in international leather trade.

(c) To set an example for other developing countries to remove restrictions on access to their hides and skins.

Because Argentina has failed to live up to its agreement to remove its restrictions on access to cattlehides, the burden on the U.S. tanning industry continues.

Argentina's restrictions are unreasonable. The Argentine tanning industry is among the most modern in the world. With its plentiful supply of raw material it has no reason to restrict access to it.

BURDENS ON THE U.S. INDUSTRY

Argentina's unreasonable restrictions on cattlehide exports severely damage the U.S. tanning industry in three ways:

(a) The restrictions that Argentina has placed on its exports of cattlehides have artificially depressed prices on its raw material. Since raw material is the largest component of leather prices, the unreasonable restrictions have given Argentina a price advantage in exporting leather to the U.S.

. . . [P]rior to its ban on the exports of cattlehides, Argentina's hides sold at or above U.S. prices. Subsequent to the ban prices of Argentine hides are a fraction of U.S. prices.

(b) Argentina's unreasonable restrictions on the exports of cattlehides damage the U.S. industry by giving an unfair advantage to Argentina in third country markets for leather. . . .

(c) Argentina's unreasonable action in restricting exports of cattlehides has placed an unfair burden on cattlehide markets in the U.S.

The accompanying chart[a] . . . of U.S. cattlehide prices shows the volatility caused partially by the decreased pool of available cattlehides on world markets. The chart shows two extreme peaks. The first, in 1972-73, illustrates the effect of the initiation of the Argentine ban on the U.S. market. The second, in 1979, was the result of the inability of countries seeking cattlehides to purchase them in countries other than the United States during a period when U.S. supplies were low due to the normal actions of the cattle cycle.

The damages inflicted by Argentina's unreasonable restrictions on exports of cattlehides are quantifiable for the first two types. In the period from 1972 to date, these damages are in the hundreds of millions of dollars in terms of lost trade to U.S. tanning companies.

The third type of damage, while not quantifiable, is possibly more important than the other two. It has created extraordinary capital demands on the U.S. industry and has added to inflationary pressures on leather and leather products in the United States.

[T]he Argentine leather tanning industry is exploiting its default of the agreement and the reduced U.S. duties on leather to increase sharply shipments of leather to the U.S. For the month of July 1981, leather imports from all countries set a new record of $32 million. Of this amount, U.S. leather imports from Argentina were $13.7 million, or 43% of the July total.

In the first seven months of 1981 cattlehide leather imports from Argentina were 83.4% higher than the first seven months of 1980. Leather imports from all sources in the same period were up 49%. These figures show the severe impact of the reductions in duties on the U.S. tanning industry. They further dramatize the extraordinary advantage that Argentina has because of its unfair trade practices.

TANNERS' COUNCIL OF AMERICA, INC.; TERMINATION OF INVESTIGATION

47 Fed. Reg. 53,989 (1982)

The United States Trade Representative, in accordance with the provisions of 15 C.F.R. 2006.6, is terminating the investigation under Section 301 of the Trade Act of 1974 (19 U.S.C. 2411) regarding the Agreement concerning Hide Exports and Other Trade Matters (the Agreement) between the Governments of the United States and Argentina entered into on August 10, 1979. . . .

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a. Omitted–Eds.

In February, 1982, U.S. Government officials began a series of consultations with officials of the Government of Argentina on the issues raised by the Tanners' Council of America [TCA]. A Federal Register notice was published on September 16, 1982 (47 FR 40959) announcing a public hearing on a proposed recommendation to the President concerning termination of the Agreement. The public hearing was held on October 6, 1982 and interested parties were given the opportunity to present their views on that proposal and on all aspects of the investigation. On October 29, 1982, the United States and Argentina mutually terminated the Agreement effective October 30, 1982, and the President by Proclamation No. 4993 (47 FR 49625, November 2, 1982) increased the column 1 rate of duty on bovine leather (TSUS 121.61) to five percent ad valorem effective October 30, 1982.

On November 9, 1982 the TCA notified the United States Trade Representative by letter of its desire to withdraw its petition.

In view of the above, the investigation of the complaint filed by the Tanners' Council of America, Inc. is terminated.

PRESIDENTIAL MEMORANDUM FOR THE UNITED STATES TRADE REPRESENTATIVE: DETERMINATION UNDER SECTION 301 OF THE TRADE ACT OF 1974

18 Weekly Comp. of Pres. Docs. 1489 (1982)

Pursuant to Section 301(a)(2) of the Trade Act of 1974 (19 U.S.C. 2411 (a)(2)), I have determined that the action described below is an appropriate and feasible response to subsidy practices of the European Community (EC), Belgium, France, Italy, the United Kingdom, Austria and Sweden, which are inconsistent with Articles 8 and 11 of the Agreement on the Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade (Subsidies Code). With a view toward eliminating the harmful effects of such practices, I am directing the United States Trade Representative (USTR) to: (1) request the United States International Trade Commission to conduct an expedited investigation under Section 201 of the Trade Act of 1974 (19 U.S.C. 2251) with regard to the five specialty steel products subject to the 301 investigation; (2) initiate multilateral and/or bilateral discussions aimed at the elimination of all trade distortive practices in the specialty steel sector; and (3) monitor imports of specialty steel products subject to the 201 proceeding. If during the pendency of the International Trade Commission section 201 investigation imports cause damage which is difficult to repair, consideration would be given to what action, if any, might appropriately be taken on an emergency, interim basis under Section 301 of the Trade Act of 1974, consistent with U.S. international obligations.

STATEMENT OF REASONS

The Office of the USTR initiated investigations under Section 301 on February 26, 1982 (47 F.R. 10107) and on August 9,1982 (47 F.R. 35387) on the basis of petitions filed by the Tool and Stainless Steel Industry Committee and the United Steelworkers of America. Petitioners principally allege that the EC and the above-mentioned countries

have subsidized the production of specialty steel in a manner inconsistent with their obligations under Articles 8 and 11 of the Subsidies Code.

Petitioners' allegations are well founded. The United States believes that subsidies have been provided by the Government of Austria in the form of grants and capitalization, by the Government of Sweden in the form of preferential loans, loan guarantees and grants, and by the European Communities and its member governments in the form of preferential loans, loan guarantees, capital grants, "recapitalization" of financial losses, interest rebate programs, exemptions from taxation, and other practices.

The injury to the domestic industry is clear. The specialty steel industry is an efficient technologically up-to-date and export-oriented branch of the steel industry. Its output is used in a wide range of demanding applications critical to an industrial economy and thus commands a price far higher than ordinary steel. Regarded as an advanced, innovative and competitive industry, specialty steel producers in the United States have tended to be more profitable than the industry as a whole and far more so than most of their major competitors abroad. Nevertheless, the industry is facing an unprecedented challenge to its continued prosperity, and a number of its member firms are fighting for survival.

Part of the problem can be traced to the recession that began in America's basic industries more than two years ago. However, it is clear that since the lifting of import quotas in February 1980, imports have steadily captured a larger share of the U.S. market, further depressing operating rates, employment, prices and revenues. Through the first eight months of 1982, imports were at historically high levels, with import penetration ratios ranging from 11 to more than 50 percent, depending on the product. In every product category, imports now exceed the surge levels established by the Department of Commerce.

The majority of these imports are currently under investigation for unfair trade practices under Section 301, the countervailing duty statute, or the anti-dumping duty statute. However, they do not cover all important, or potentially important, sources of specialty steel imports. A partial remedy against unfair imports can be rendered meaningless by a substitution of new foreign suppliers for those whose shipments are affected. Thus, the specific subsidy complaints could lead to a remedy that fails to resolve the overall import problem. Moreover, dealing with the specific subsidy problem itself probably would not have a great impact on the world steel trading environment in which our industry must compete. Subsidies are only one of a wide range of trade restrictive and trade distortive practices that many of our trading partners engage in to protect their industries and to stimulate exports. If we are ever to put an end to constant trade disputes in steel, we must stop dealing with discrete import and export issues in isolation and instead begin a coordinated approach to the problem. By combining the Section 201 and Section 301 approaches, the United States hopes to stabilize the immediate import situation and to reverse the global trend toward greater excess capacity, increased subsidization, and closed markets. . . .

NOTES AND QUESTIONS

1. Are you troubled at giving the president essentially unfettered discretion to choose the commodities on which to impose retaliatory tariffs and to choose whether or not to impose these tariffs on a discriminatory basis or an MFN basis? For an interesting example, see *United States v. Star Industries*, 462 F.2d 557 (C.C.P.A. 1972), *cert. denied*, 409 U.S. 1076. Is there any alternative to providing so much discretion?

2. As a matter of GATT design (or of voting on an individual case), would you prefer the discriminatory approach or the MFN approach to retaliatory tariffs? Is the issue different from its analogue under GAIT Article XIX?

3. Was the president right in brushing off the U.S. TV station's complaint about Canadian Bill C-58? Was it really a brush off? Note that in 1984 Congress passed the requested legislation. Do the U.S. stations have any judicial relief against the president? For additional data, see Fisher & Steinhardt, *Section 301 of the Trade Act of 1974: Protection for U.S. Exports of Goods, Services, and Capital*, 14 LAW & POL. INT'L. BUS. 569, 639-652 (1982).

4. Did Canada's action in that case violate the GATT? How might this event relate to subsequent efforts to bring trade in services under GATT-style rules?[1]

5. Do you think the Tanners' Council would have won a countervailing duty proceeding against Argentina? What is the difference between what the tanners must show under the two sections? What about possible remedies?

6. Does the use of a § 301 proceeding–which lacks some of the procedural formalities favoring free trade found in the countervailing duty laws–bother you in this case? Or does the existence of an agreement with Argentina really make this situation different from the usual countervailing duty case?

7. How voluntary do you think the final upshot was on Argentina's part? Again, is the trend favorable to developing nations?

8. Should § 301 proceedings be pursued simultaneously with countervailing duty proceedings? For a decision that, "in order to avoid redundant remedies and the waste of limited government resources," they need not be so pursued, see Office of the United States Trade Representative, *Industrial Union Department, AFL-CIO; Termination of Complaint*, 47 Fed. Reg. 42,059 (1982). How would you advise the AFL-CIO if asked about the likely outcome of a legal attack on this determination?

9. In the face of *Industrial Union Department*, why is the government attempting to cumulate § 201 and § 301 remedies in *Specialty Steel*–given that the issue is one plausibly best covered by the countervailing duty laws? Is this a necessary result of the existence of the Subsidies Code dispute settlement procedure? A way to orient the trade law process toward VRAs and OMAs to obtain greater protection and higher prices? Note that the ITC subsequently found injury pursuant to § 201 and the President imposed quantitative restraints and duties on imported specialty steel products.

10. Is § 301 likely to become a catch-all absorbing all other domestic trade law procedures?

11. Need the government be consistent as between the position it takes in the GATT discussions and that which it takes under domestic law? For an example (the "cattle war") in which the United States gave radically different legal descriptions of a Canadian action in the two contexts, see Hudec, *Retaliation Against "Unreasonable" Foreign Trade Practices: The New Section 301 and GATT Nullification and Impairment*, 59 Minn. L. Rev. 461, 535-539 (1975).

12. If a GATT panel has found against the United States in a trade conflict, how is this finding relevant to a § 301 action?

13. During the 1982-1984 period, U.S. and EC agricultural interests faced a series of disputes over, for example, a highly subsidized U.S. wheat sale to Egypt, a GATT panel

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1. For a general example of early congressional interest in this regard, not specifically tied to the Canadian example, see *Trade in Services and Trade in High Technology Products: Hearing Before the Subcommittee on Trade of the House Committee on Ways and Means*, 97th Cong., 2d Sess. 60 (1982).

decision that certain EC export subsidies did not violate GATT, U.S. claims that the EC was improperly subsidizing poultry exports, pasta exports, and raisin exports and that these exports were hurting U.S. markets. In the midst of this unresolved conflict, the EC, faced with enormous agricultural subsidy costs, was considering major revamping of its agricultural program, revamping that would (almost necessarily) increase protection of some items while that of others might be reduced. What would you do if you

(a) represented a U.S. grain substitute or oilseed firm likely to be hurt by the EC reshuffling?

(b) represented a dairy firm likely to be helped by the same reshuffling?

(c) were the USTR?

(d) were the Secretary of Agriculture?

For additional data, see Butler, *The Ploughshares War Between Europe and America*, 62 Foreign Affairs 105 (1983); Echols, *Just Friends: The U.S.-E.E.C. Agricultural Export Subsidies Standoff*, 1983 Proc. Am. Soc. Int'l. L. 119 (1985).

14. U.S. Sake, a California corporation produces sake in California for sale in the United States and for export. In addition to selling to the growing U.S.-Japanese restaurant market, U.S. Sake would like to export sake to Japan, which is, of course, a highly "educated" market with respect to sake. Currently, 99% of all sake sold in Japan is produced in Japan. Sake is classified as a wine under the applicable U.S. Treasury Bureau of Alcohol, Tobacco and Firearms (BATF) regulations, and is also classified as a wine by various states. In addition, U.S. Sake belongs to the Wine Institute, a trade association designed to promote U.S. wines. Sake, however, is imported into the United States as a "malt" under the Tariff Schedules of the United States (TSUS), and is derived from rice. Always eager to gain assistance from the U.S. government, U.S. Sake intends to apply for an export incentive program offered by the U.S. Department of Agriculture's Foreign Agricultural Service.

(a) You are counsel to the president of Japan Sake, a Tokyo corporation that is directly competitive with U.S. Sake in the United States and Japan. Through industry sources, it has come to your attention that USDA is about to award a substantial export promotion allowance to U.S. Sake for exports to Japan, a matter of some concern since U.S. Sake's products retail at 10% below the price of Japan Sake's goods, and may indeed be currently selling at below the cost of production in overseas markets. What advice will you give to the President of Japan Sake? Should he have Japan Sake go to the Government of Japan to have this matter raised with the United States as a violation of applicable trade agreements?

(b) If you were representing the United States, in your capacity as General Counsel to the Office of the U.S. Trade Representative, how would you defend the U.S. program before any possible WTO panel summoned by Japan to consider the Wine Promotion Allowance?

(c) What if the target market in this problem were not Japan but Burma? How would this fact alter your conclusions? An outline of the Export Incentive Program for U.S. wines follows:

This program is designed to assist U.S. wineries in promoting their own brand(s) in specific countries. All varietal and proprietary grape and fruit wines produced by vintners in the United States are eligible under this program. Exports of bulk wines may be included if the foreign bottler maintains the U.S. identity of the products and clearly identifies them as U.S. wine.

PROMOTIONAL ACTIVITIES. Promotional activities acceptable in the calculation of promotional expenditures include: in-store demonstrations, point-of-sale materials, wine tastings and consumer or trade advertising. Salaries, international travel, price-off deals and giveaways may not be included.

CONTRACTS. Contracts are signed for a three-year term, but may be funded each year to assure funding at appropriate levels. Contractees may claim reimbursement at the end of each marketing year. The marketing years for the purposes of this program are either from October 1 through September 30, or from July 1 through June 30, whichever is more convenient for the participating firm.

TERMS OF PAYMENT FAS payment will be the lesser of the following:

A. Fifty percent of the firm's (and/or third party's) total expenditures for promotion of U.S. wines or

B. The following percentages of the f.a.s. value[a] of a winery's exports to selected countries in the same marketing year, according to the schedule below:

Year in Program	FAS Payment
1st	10% of Export Sales
2nd	7% of Export Sales
3rd	5% of Export Sales

N.B.: while the Foreign Agricultural Service will be as responsive as possible to applications, budgetary limitations may require proration of our funds if the response to this program remains high.

16. The next chapter deals with the regulation of trade and the problems of developing countries (LDCs). Many LDCs have described the GATT as a "rich man's club." Are you satisfied with the treatment of developing countries by the GATT? Do you think the GATT codes that you have studied so far on subsidies, dumping, government procurement, standards and customs valuation have dealt fairly with LDCs? Should the GATT be expanded to regulate international commodity markets–of concern to LDCs–through export quota arrangements, buffer stock agreements, and multilateral contracts? Mexico, an LDC that–at the time–was struggling with tremendous foreign debt problems, finally joined the GATT in 1985. How will membership in the GATT be of assistance to Mexico?

17. How should international trade disputes be settled–on a juridical basis, or by using a negotiating or political approach expressing the relative strength of the parties? Are these two approaches mutually exclusive, or could both be employed, for the same dispute, on parallel tracks? Do the DSU and § 301 procedures represent two such tracks? Are the sanctions used by the GATT–withdrawal of substantially equivalent concessions–strong enough to insure compliance with the agreement or its subcodes? How would you compare sanctions under the GATT with with sanctions under § 301?

18. Are § 301 procedures consistent with U.S. obligations under the WTO, and particularly with the DSU? The unilateral character–and often aggressive and threatening tenor–of § 301 procedures have been criticized by U.S. trading partners as

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a. On FAS as a contract term, see *supra* Chapter II at ▬.

inconsistent the objectives and expectations of the WTO system. In 1998, the EU finally mounted a formal challenge to the legality of § 301. The excerpted panel report represents the results of that challenge.

UNITED STATES–SECTIONS 301-310 OF THE TRADE ACT OF 1974

WT/DS152/R, December 22, 1999

I. PROCEDURAL BACKGROUND

. . .

1.2 On 25 November 1998, the European Communities requested consultations with the United States under Article XXII:1 of the General Agreement on Tariffs and Trade 1994 ("GATT 1994") and Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Dispute ("DSU") with regard to Title III, chapter 1 (Sections 301-310) of the United States Trade Act of 1974, as amended (19 U.S.C., [§§] 2411-2420) (WT/DS152/1). The United States agreed to the request. Dominica Republic, Panama, Guatemala, Mexico, Jamaica, Honduras, Japan, and Ecuador requested . . . to be joined in those consultations, pursuant to Article 4.11 of the DSU. Consultations between the European Communities and the United States were held on 17 December 1998, but the parties were unable to settle the dispute.

1.3 On 26 January 1999, the European Communities requested the establishment of a panel pursuant to Article 6 of the DSU (WT/DS152/11).

1.4 In its panel request, the European Communities claims that:

> By imposing specific, strict time limits within which unilateral determinations must be made and trade sanctions must be taken, Sections 306 and 305 of the Trade Act of 1974 do not allow the United States to comply with the rules of the DSU in situations where a prior multilateral ruling under the DSU on the conformity of implementing measures has not yet been adopted by the DSB. Where measures have been taken to implement DSB recommendations, the DSU rules require either agreement between the parties to the dispute or a multilateral finding on non-conformity under Article 21.5 DSU before any determination of non-conformity can be made, let alone any measures of retaliation can be announced or implemented. The DSU procedure resulting in a multilateral finding, even if initiated immediately at the end of the reasonable period of time for implementation, cannot be finalised, nor can the subsequent DSU procedure for seeking compensation or suspension of concessions be complied with, within the time limits of Sections 306 and 305.
>
> The European Communities considers that Title III, chapter1 (Sections 301-310) of the Trade Act of 1974, as amended, and in particular Sections 306 and 305 of that Act, are inconsistent with, in particular, but not necessarily exclusively, the following WTO provisions
>
> (a) Articles 3, 21, 22 and 23 of the DSU;
>
> (b) Articles XVI:4 of the Marrakesh Agreement Establishing the World Trade Organization; and
>
> (c) Articles I, II, III, VIII and XI of GATT1994.
>
> Through these violations of WTO rules, this legislation nullifies or impairs benefits accruing, directly or indirectly, to the European Communities under GATT 1994. This legislation also impedes important objectives of the GATT 1994 and of the WTO.

1.5 The Dispute Settlement Body ("DSB") agreed to this request for a panel at its

meeting of 2 March 1999, establishing a panel pursuant to Article 6 of the DSU. In accordance with Article 7.1 of the DSU, the terms of reference of the Panel were:

> To examine, in the light of the relevant provisions of the covered agreements cited by the European Communities in document WT/DS152/11, the matter referred to the DSB by the European Communities in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements.

1.6 Brazil, Cameroon, Canada, Columbia, Costa Rica, Cuba, Dominica, Dominican Republic, Ecuador, Hong Kong (China), India, Israel, Jamaica, Japan, Korea, St. Lucia, and Thailand, reserved their rights to participate in the Panel proceedings as third parties. Cameroon later withdrew its reservations as a third party. . . .

VII. FINDINGS

A. Claims of The Parties

. . .

7.2 The EC claims that by adopting, maintaining on its statute book and applying Sections 301-310 of the 1974 Trade Act after the entry into force of the Uruguay Round Agreements, the US has breached the historical deal that was struck in Marrakech between the US and the other Uruguay Round participants. According to the EC, this deal consists of a trade-off between, on the one hand, the practical certainty of adoption by the Dispute Settlement Body ("DSB") of panel and Appellate Body reports and of authorization for Members to suspend concessions–in the EC's view, an explicit US request–and, on the other hand, the complete and definitive abandoning by the US of its long-standing policy of unilateral action. The EC submits that the second leg of this deal, which is, in its view, the core of the present Panel procedure, has been enshrined in the following WTO provisions: Articles 3, 21, 22 and, most importantly, 23 of the DSU and Article XVI:4 of the WTO Agreement.

7.3 The EC claims, more particularly, that

> (a) inconsistently with Article 23.2(a) of the DSU:
>
> • Section 304 (a)(2)(A) requires the US Trade Representative ("USTR") to determine whether another Member denies US rights or benefits under a WTO agreement irrespective of whether the DSB adopted a panel or Appellate Body finding on the matter; and
>
> • Section 306 (b) requires the USTR to determine whether a recommendation of the DSB has been implemented irrespective of whether proceedings on this issue under Article 21.5 of the DSU have been completed;
>
> (b) inconsistently with Article 23.2(c) of the DSU:
>
> • Section 306 (b) requires the USTR to determine what further action to take under Section 301 in case of a failure to implement DSB recommendations; and
>
> • Section 305 (a) requires the USTR to implement that action,
>
> and this in both instances, irrespective of whether the procedures set forth in Articles 21.5 and 22 of the DSU have been completed; and
>
> (c) Section 306 (b) is inconsistent with Articles I, II, III, VIII and XI of GATT 1994 because, in the case of disputes involving trade in goods, it requires the USTR to impose duties, fees or restrictions that violate one or more of these provisions.

7.4 The EC submits that Sections 301-310, on their face, mandate unilateral action by the US authorities in breach of Article 23 of the DSU and consequently of Articles

I, II, III, VIII and XI of the GATT 1994. . . .

7.5 In addition, the EC argues that Sections 301-310–even if they could be interpreted to permit the USTR to avoid WTO-inconsistent determinations and actions–cannot be regarded as a sound legal basis for the implementation of the US obligations under the WTO. For the EC, the lack of this "sound legal basis" produces a situation of threat and legal uncertainty against other WTO Members and their economic operators that fundamentally undermines the "security and predictability" of the multilateral trading system.

7.6 The EC submits, furthermore, that Sections 301-310 are not in conformity with US obligations under the WTO since they are an expression of a deliberate policy creating a pattern of executive action which is biased against WTO-conformity. According to the EC, even if Sections 301-310 could be interpreted to provide the USTR with a legal basis for the implementation of US obligations under the WTO, they could not be considered to be in conformity with WTO law within the meaning of Article XVI.4 of the WTO Agreement.

7.7 On these grounds, the EC requests us to rule that the US, by failing to bring the Trade Act of 1974 into conformity with the requirements of Article 23 of the DSU and Articles I, II, III, VIII and XI of the GATT 1994, acted inconsistently with its obligations under those provisions and under Article XVI:4 of the WTO Agreement and thereby nullifies or impairs benefits accruing to the EC under the DSU, GATT 1994 and the WTO Agreement. . . .

7.9 The US responds that the EC has brought a political case that is in search of a legal argument. It submits that the EC is not entitled to prevail in this dispute on the basis of a series of assumptions adverse to the US, assumptions both with respect to the decisions the USTR can make under Sections 301-310 and with respect to panel, Appellate Body and DSB meeting schedules. According to the US, Sections 301-310 permit the US to comply with DSU rules and procedures in every case: Section 304 permits the USTR to base his or her determinations on adopted panel and Appellate Body findings in every case; and Sections 305 and 306 permit the USTR, in every case, to request and receive DSB authorization to suspend concessions in accordance with Article 22 of the DSU. The US concludes that it fully meets its WTO obligations in this respect.

B. Preliminaries

. . .

2. The Panel's Mandate

7.11 The political sensitivity of this case is self-evident. In its submissions, the US itself volunteered that Sections 301-310 are an unpopular piece of legislation. In addition to the EC, twelve of the sixteen third parties expressed highly critical views of this legislation.

7.12 Our function in this case is judicial. In accordance with Article 11 of the DSU, it is our duty to "make an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements".

7.13 The mandate we have been given in this dispute is limited to the specific EC claims. . . . We are not asked to make an overall assessment of the compatibility of

Sections 301-310 with the WTO agreements. It is not our task to examine any aspects of Sections 301-310 outside the EC claims. We are, in particular, not called upon to examine the WTO compatibility of US actions taken in individual cases in which Sections 301-310 have been applied. Likewise, we have not been asked to address the WTO consistency of those provisions in Section 301-310 relating to determinations and actions taken by the USTR that do not concern the enforcement of US rights under the WTO Agreement, including the provisions authorizing the USTR to make a determination as to whether or not a matter falls outside the scope of the WTO agreements.

3. Fact Finding: Rules on Burden of Proof and Interpretation of Domestic Legislation

(a) Burden of Proof - General

7.14 Part of our task in accordance with Article 11 of the DSU is to make factual findings. We are guided in this matter, as well as others, by the jurisprudence of the Appellate Body. In accordance with this jurisprudence, both parties agreed that it is for the EC, as the complaining party, to present arguments and evidence sufficient to establish a prima facie case in respect of the various elements of its claims regarding the inconsistency of Sections 301-310 with US obligations under the WTO. Once the EC has done so, it is for the US to rebut that prima facie case. Since, in this case, both parties have submitted extensive facts and arguments in respect of the EC claims, our task will essentially be to balance all evidence on record and decide whether the EC, as party bearing the original burden of proof, has convinced us of the validity of its claims. In case of uncertainty, i.e. in case all the evidence and arguments remain in equipoise, we have to give the benefit of the doubt to the US as defending party.

7.15 We note, in addition, that the party that alleges a specific fact–be it the EC or the US–has the burden to prove it. In other words, it has to establish a prima facie case that the fact exists. Following the principles set out in the previous paragraph, this prima facie case will stand unless sufficiently rebutted by the other party.

7.16 The factual findings in this Report were reached applying these principles. Of course, when it comes to deciding on the correct interpretation of the covered agreements a panel will be aided by the arguments of the parties but not bound by them; its decisions on such matters must be in accord with the rules of treaty interpretation applicable to the WTO.

(b) Examination of Domestic Legislation

7.17 In respect of the examination of domestic law by WTO panels, both parties referred to the India - Patents (US) case. There the Appellate Body stated that "[i]t is clear that an examination of the relevant aspects of Indian municipal law ... is essential to determining whether India has complied with its obligations under Article 70.8(a) [of the TRIPS Agreement]. There was simply no way for the Panel to make this determination without engaging in an examination of Indian law".[633]

7.18 In this case, too, we have to examine aspects of municipal law, namely Sections 301-310 of the US Trade Act of 1974. Our mandate is to examine Sections 301-310

633. Appellate Body Report on India - Patent Protection for Pharmaceutical and Agricultural Chemical Products ("India - Patents (US)"), WT/DS50/AB/R (complaint by US), adopted 16 January 1998, para. 66.

solely for the purpose of determining whether the US meets its WTO obligations. In doing so, we do not, as noted by the Appellate Body in India - Patents (US), interpret US law "as such", the way we would, say, interpret provisions of the covered agreements. We are, instead, called upon to establish the meaning of Sections 301-310 as factual elements and to check whether these factual elements constitute conduct by the US contrary to its WTO obligations. The rules on burden of proof for the establishment of facts referred to above also apply in this respect.[635]

7.19 It follows that in making factual findings concerning the meaning of Sections 301-310 we are not bound to accept the interpretation presented by the US. That said, any Member can reasonably expect that considerable deference be given to its views on the meaning of its own law.

7.20 We note, finally, that terms used both in Sections 301-310 and in WTO provisions, do not necessarily have the same meaning. For example, the word "determination" need not always have the same meaning in Sections 304 and 306 as it has in Article 23.2(a) of the DSU. Thus, conduct not meeting, say, the threshold of a "determination" under Sections 304 and 306, is not by this fact alone precluded from meeting the threshold of a "determination" under Article 23.2(a) of the DSU. By contrast, the fact that a certain act is characterized as a "determination" under domestic legislation, does not necessarily mean that it must be construed as a determination under the covered agreements.

4. Rules of Treaty Interpretation

7.21 Evaluating the conformity of Sections 301-310 with US obligations under the WTO requires interpretation of several provisions of the covered agreements. Article 3.2 of the DSU directs panels to clarify WTO provisions "in accordance with customary rules of interpretation of public international law". Articles 31 and 32 of the Vienna Convention on the Law of Treaties ("Vienna Convention") have attained the status of rules of customary international law. In recent years, the jurisprudence of the Appellate Body and WTO panels has become one of the richest sources from which to receive guidance on their application. The principal provision of the Vienna Convention in this respect provides as follows:

> 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.[637]

7.22 Text, context and object-and-purpose correspond to well established textual, systemic and teleological methodologies of treaty interpretation, all of which typically come into play when interpreting complex provisions in multilateral treaties. For pragmatic reasons the normal usage, and we will follow this usage, is to start the interpretation from the ordinary meaning of the "raw" text of the relevant treaty provisions and then seek to construe it in its context and in the light of the treaty's object and purpose. However, the elements referred to in Article 31–text, context and object-

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635. In this respect, the International Court of Justice ("ICJ"), referring to an earlier judgment by the Permanent Court of International Justice ("PCIJ") noted the following: "Where the determination of a question of municipal law is essential to the Court's decision in a case, the Court will have to weigh the jurisprudence of the municipal courts, and 'If this is uncertain or divided, it will rest with the Court to select the interpretation which it considers most in conformity with the law' (Brazilian Loans, PCIJ, Series A, Nos. 20/21, p. 124)" (Elettronica Sicula S.p.A. (ELSI), Judgment, ICJ Reports 1989, p. 47, para. 62).

637. [Vienna Convention, art. 31, para. 1.]

and-purpose as well as good faith–are to be viewed as one holistic rule of interpretation rather than a sequence of separate tests to be applied in a hierarchical order. Context and object-and-purpose may often appear simply to confirm an interpretation seemingly derived from the "raw" text. In reality it is always some context, even if unstated, that determines which meaning is to be taken as "ordinary" and frequently it is impossible to give meaning, even "ordinary meaning", without looking also at object-and-purpose. As noted by the Appellate Body: "Article 31 of the Vienna Convention provides that the words of the treaty form the foundation for the interpretive process: 'interpretation must be based above all upon the text of the treaty"'. It adds, however, that "[t]he provisions of the treaty are to be given their ordinary meaning in their context. The object and purpose of the treaty are also to be taken into account in determining the meaning of its provisions".[639] . . .

C. THE EC CLAIM THAT SECTION 304 IS INCONSISTENT WITH ARTICLE 23.2(a) OF THE DSU

1. Claims and Arguments of the Parties

7.29 The EC claims that Section 304 mandates the USTR to make a "unilateral" determination on whether another WTO Member has violated US rights under the WTO. The EC submits that this determination by the USTR has to be made within 18 months after the initiation of an investigation under Section 302, a date that normally coincides with the request for consultations under the DSU. According to the EC, DSU procedures can, however, be assumed to take 19½ months. The EC submits that, as a result of the 18 months deadline, the determination under Section 304 is required even if the DSB has not yet adopted a report with findings on the matter, contrary to Article 23.2(a) of the DSU.

7.30 The US responds that nothing in Section 304 compels the USTR to make a specific determination that US rights have been denied in the absence of panel or Appellate Body findings, adopted by the DSB. In its second submission, the US goes even further and submits that since Section 304 determinations have to be made on the basis of WTO dispute settlement proceedings pursuant to Section 304(a)(1), a determination that US rights have been denied before the adoption of DSB findings is precluded. According to the US, Section 304 only requires the USTR to "determine whether"–not to determine that–US rights have been denied. In the US view, the USTR has the discretion to determine that no violation has occurred, that no violation has been confirmed by the DSB, that a violation will be confirmed on the date the DSB adopts panel or Appellate Body findings or that the ongoing investigation must terminate. The US also argues that the relevant period for DSU procedures to be completed–from the request for consultations to the adoption of reports by the DSB–is not 19½ months, as claimed by the EC, but 16 months and 20 days.

2. Preliminary Panel Findings in respect of the Statutory Language of Section 304

7.31 As regards the statutory language of Section 304, we consider it sufficient to

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639. Appellate Body report on Japan - Taxes on Alcoholic Beverages ("Japan - Alcoholic Beverages"), WT/DS8/AB/R, adopted 1 November 1996, pp. 11-12.

make the following findings based upon examination of the text itself, the evidence and arguments submitted to us in this respect as well as interpretation, where applicable, of the relevant provisions of the WTO.

(a) First, as a matter of fact, we find that under the statutory language of Section 304 (a)(2), the USTR is mandated, i.e. obligated in law, to make a determination on whether US rights are being denied within 18 months after the request for consultations.[640] This is a mandatory feature of Section 304 in which the Legislature left no discretion to the Executive Branch.[641]

(b) Second, as a matter of law, since most of the time-limits in the DSU are either minimum time-limits without ceilings[642] or maximum time-limits that are, nonetheless, indicative only,[643] DSU proceedings–from the request for consultations to the adoption of findings by the DSB[644]–may take longer than 18 months and have in practice often led to time-frames beyond 18 months.[645] As a result, the USTR could be obligated in certain cases brought by the US–and indeed in certain cases has already been so obligated–to make a unilateral determination as to whether US rights are being denied before the completion of multilateral DSU proceedings.

(c) Third, as a matter of fact, we find that even though the USTR is obligated to make a determination within the 18 months time-frame, under the broad discretion allowed under Section 304 there are no circumstances which would compel him or her to make a determination to the effect that US rights under the WTO Agreement have been denied–hereafter referred to as a "determination of inconsistency"–before the exhaustion of DSU proceedings.

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640. For purposes of this dispute, we assume that the 18 months time-limit is the earlier of the two time-limits mentioned in Section 304, i.e. falls before the lapse of "30 days after the date on which the dispute settlement procedure is concluded".

641. The US agrees that it cannot postpone the making of this determination. In respect of Japan - Measures Affecting Agricultural Products ("Japan - Agricultural Products"), adopted 19 March 1999, WT/DS76/AB/R and India - Patents (US), for example, the US . . . stated that "the United States did not make formal Section 304 determinations by the 18-month anniversary, but should have".

642. Article 4.7 of the DSU, for example, provides for a minimum period of 60 days for consultations, unless there is agreement to the contrary or urgency in accordance with Article 4.8.

643. Article 12.8 refers to six months "as a general rule" for the timeframe between panel composition and issuance of the final report to the parties. Article 12.9 provides that "[i]n no case should the period from the establishment of the panel to the circulation of the report to the Members exceed nine months". . . . Article 17.5 states that "[a]s a general rule, the proceedings [of the Appellate Body] shall not exceed 60 days". It adds, however, that "[i]n no case shall the proceedings exceed 90 days". However, even this seemingly compulsory deadline has been passed in three cases so far (United States - Restrictions on Imports of Cotton and Man-Made Fibre Underwear, WT/DS24/AB/R, 91 days; European Communities - Measures Concerning Meat and Meat Products (Hormones) ("EC - Hormones"), WT/DS26/AB/R and DS48/AB/R, 114 days; and US - Shrimp, op. cit., 91 days). Finally, Article 20 refers to 9 months–12 months in case of an appeal–"as a general rule" for the period between panel establishment and adoption of report(s) by the DSB.

644. When we refer hereafter to the exhaustion of DSU proceedings, we mean the date of adoption by the DSB of panel and, as the case may be, Appellate Body reports on the matter.

645. In 17 cases out of the 26 cases which so far led to DSB recommendations, more than 18 months lapsed between the request for consultations and the adoption of reports. Eleven of these 17 cases were brought by the US either as the sole complainant or a co-complainant: European Communities - Regime for the Importation, Sale and Distribution of Bananas ("EC - Bananas III", WT/DS27), EC - Hormones (op. cit.), Japan - Measures Affecting Consumer Photographic Film and Paper (WT/DS44), India - Patents (US) (op. cit.), European Communities/United Kingdom/Ireland - Customs Classification of Certain Computer Equipment (WT/DS62, 67 and 68), Indonesia - Certain Measures Affecting the Automobile Industry (WT/DS54, 55, 59 and 64), Japan - Agricultural Products (op. cit.), Korea - Taxes on Alcoholic Beverages (WT/DS75 and 84), Australia - Subsidies Provided to Producers and Exporters of Automobile Leather (WT/DS106), India - Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products (WT/DS90) and Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products (WT/DS103, US complaint and WT/DS113, complaint by New Zealand). The six other cases were: US - Shrimp (op. cit.), Australia - Measures Affecting the Importation of Salmon (WT/DS18), Guatemala - Anti-Dumping Investigation Regarding Portland Cement from Mexico (WT/DS60), US - Anti-Dumping Duty on Dynamic Random Access Memory Semiconductors (DRAMS) of one Megabit or above from Korea (WT/DS99), Brazil - Export Financing Programme for Aircraft (WT/DS46) and Canada - Measures Affecting the Export of Civilian Aircraft ("Canada - Aircraft", WT/DS70).

Section 304 (a) requires the USTR to determine whether US rights are being denied within 18 months. It does not require the USTR to determine that US rights are being denied at the 18 months deadline. The criteria referred to in Section 304 (a) on which the USTR has to base its determination–"the investigation initiated under section 302 ... and the consultations (and the proceedings, if applicable) under section 303"–allow the USTR to exercise wide discretion in all cases concerning the actual content of the determination he or she has to make.

As will be seen below, however, this discretion does not necessarily absolve Section 304 from a breach of the DSU.

(d) Fourth, as a matter of fact, we find that even though the USTR is not obligated, under any circumstance, to make a Section 304 determination of inconsistency prior to exhaustion of DSU proceedings, it is not precluded by the statutory language of Section 304 itself from making such a determination.[646] We find that the broad discretion given to the USTR allows him or her to do exactly what the statutory language suggests: to determine whether US rights have been denied, i.e. to determine that they have not been denied but also to determine that they have been denied.[647]

7.32 In conclusion, the statutory language of Section 304 mandates the USTR in certain cases to make a unilateral determination on whether US rights have been denied even before the adoption by the DSB of its findings on the matter. However, the statutory language of Section 304 neither mandates the USTR to make a determination of inconsistency nor precludes him or her from making such a determination.

7.33 Critically, the statutory language of Section 304 reserves to the USTR when exercising his or her mandatory duty after 18 months, the right to make a unilateral determination of inconsistency even prior to exhaustion of DSU proceedings.

3. The Statutory Language of Section 304 and Member Obligations under Article 23 of the DSU

7.34 The statutory language of Section 304 reserves, then, to the USTR when exercising his or her mandatory duty after 18 months, the right to make a unilateral determination of inconsistency even prior to exhaustion of DSU proceedings. As noted, it does not impose on the USTR the duty to make such a determination. What is at issue, then, is whether–given, on the one hand, the duty in some cases to make a unilateral determination prior to exhaustion of multilateral proceedings and, on the other hand, the full discretion as to the content of that determination–Section 304 violates, in and of itself rather than with reference to any particular instance of its application, the

646. The US argued in its second submission that the USTR is precluded from making such a determination of inconsistency. To the extent this US argument is based on the statutory language of Section 304 alone, we reject the argument for the reasons given in this Report.

647. Section 304 (a) refers to WTO "proceedings, if applicable" as a basis of the determination to be made. This statutory language is not sufficiently precise to construe it as curtailing the USTR's discretion to make a determination of inconsistency before the adoption of findings by the DSB. The reference to "proceedings" as a basis for the determination allows WTO proceedings to be taken into account but does not, in our view, preclude a determination of inconsistency before the final outcome of WTO proceedings, i.e. before the adoption of DSB recommendations. We note that whereas the first time-limit under Section 304 (a)(2) explicitly refers to the conclusion of dispute settlement procedures ("30 days after the date on which the dispute settlement procedure is concluded"), the second time-limit does not refer to any proceedings, let alone to the completion of WTO proceedings ("18 months after the date on which the investigation is initiated"). Section 304 (a)(2) mandates the making of a determination "the earlier of" these two time-limits. We note, finally, that the US itself had first argued that Section 304 does not "compel" the making of a determination of inconsistency which seems to imply that although not compelled, the USTR is permitted to make such a determination. Only in its second submission did the US argue that the USTR is actually "precluded" from making such determination.

obligations assumed by Members under Article 23.2(a) of the DSU. We must, thus, turn to the interpretation of Article 23 of the DSU.

(a) The dual nature of obligations under Article 23 of the DSU

7.35 Article 23 of the DSU deals, as its title indicates, with the "Strengthening of the Multilateral System". Its overall design is to prevent WTO Members from unilaterally resolving their disputes in respect of WTO rights and obligations. It does so by obligating Members to follow the multilateral rules and procedures of the DSU. [The panel quotes DSU article 23.1, .2.] . . .

7.38 On this basis, we conclude as follows:

> (a) It is for the WTO through the DSU process–not for an individual WTO Member–to determine that a WTO inconsistency has occurred (Article 23.2(a)).
>
> (b) It is for the WTO or both of the disputing parties, through the procedures set forth in Article 23–not for an individual WTO Member–to determine the reasonable period of time for the Member concerned to implement DSB recommendations and rulings (Article 23.2(b)).
>
> (c) It is for the WTO through the procedures set forth in Article 22–not for an individual WTO Member–to determine, in the event of disagreement, the level of suspension of concessions or other obligations that can be imposed as a result of a WTO inconsistency, as well as to grant authorization for the actual implementation of these suspensions.

7.39 Article 23.2 clearly, thus, prohibits specific instances of unilateral conduct by WTO Members when they seek redress for WTO inconsistencies in any given dispute. This is, in our view, the first type of obligations covered under Article 23.

7.40 It is not, however, our task in these proceedings to assess the WTO conformity of specific determinations made under Section 304 in a given dispute but to determine, instead, whether Section 304 as such violates Article 23 of the DSU. This leads us to the second type of obligations covered under Article 23.

7.41 As a general proposition, GATT acquis, confirmed in Article XVI:4 of the WTO Agreement and recent WTO panel reports, make abundantly clear that legislation as such, independently from its application in specific cases, may breach GATT/WTO obligations:

> (a) In GATT jurisprudence, to give one example, legislation providing for tax discrimination against imported products was found to be GATT inconsistent even before it had actually been applied to specific products and thus before any given product had actually been discriminated against.[648]
>
> (b) Article XVI:4 of the WTO Agreement explicitly confirms that legislation as such falls within the scope of possible WTO violations. . . . The three types of measures

648. See, for example, Panel Reports on United States - Taxes on Petroleum and Certain Imported Substances ("US - Superfund"), adopted 17 June 1987, BISD 34S/136, para. 5.2.2 (where the legislation imposing the tax discrimination only had to be applied by the tax authorities at the end of the year after the panel examined the matter) and United States - Measures Affecting Alcoholic and Malt Beverages ("US - Malt Beverages"), adopted 19 June 1992, BISD 39S/206, paras. 5.39, 5.57, 5.60 and 5.66 (where the legislation imposing the discrimination was, for example, not being enforced by the authorities). See also Panel Reports on EEC - Regulation on Imports of Parts and Components ("EEC - Parts and Components"), adopted 16 May 1990, BISD 37S/132, paras. 5.25- 5.26, Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes ("Thai - Cigarettes"), adopted 7 November 1990, BISD 37S/200, para. 84 and United States - Measures Affecting the Importation, Internal Sale and Use of Tobacco ("US - Tobacco"), adopted 4 October 1994, BISD 41S/131, para. 118.

explicitly made subject to the obligations imposed in the WTO agreements–"laws, regulations and administrative procedures"–are measures that are applicable generally; not measures taken necessarily in a specific case or dispute. Article XVI:4, though not expanding the material obligations under WTO agreements, expands the type of measures made subject to these obligations.[649]

(c) Recent WTO panel reports confirm, too, that legislation as such, independently from its application in a specific case, can be inconsistent with WTO rules.[650] . . .

7.43 Article 23.1 is not concerned only with specific instances of violation. It prescribes a general duty of a dual nature. First, it imposes on all Members to "have recourse to" the multilateral process set out in the DSU when they seek the redress of a WTO inconsistency. In these circumstances, Members have to have recourse to the DSU dispute settlement system to the exclusion of any other system, in particular a system of unilateral enforcement of WTO rights and obligations. This, what one could call "exclusive dispute resolution clause", is an important new element of Members' rights and obligations under the DSU. Second, Article 23.1 also prescribes that Members, when they have recourse to the dispute settlement system in the DSU, have to "abide by" the rules and procedures set out in the DSU. This second obligation under Article 23.1 is of a confirmatory nature: when having recourse to the DSU Members must abide by all DSU rules and procedures.

7.44 Turning to the second paragraph under Article 23, Article 23.2–which, on its face, addresses conduct in specific disputes–starts with the words "[i]n such cases". It is, thus, explicitly linked to, and has to be read together with and subject to, Article 23.1.

7.45 Indeed, two of the three prohibitions mentioned in Article 23.2–Article 23.2(b) and (c)–are but egregious examples of conduct that contradicts the rules and procedures of the DSU which, under the obligation in Article 23.1 to "abide by the rules and procedures" of the DSU, Members are obligated to follow.[651] These rules and procedures clearly cover much more than the ones specifically mentioned in Article 23.2.[652] There is a great deal more State conduct which can violate the general obligation in Article 23.1 to have recourse to, and abide by, the rules and procedures of the DSU than the instances especially singled out in Article 23.2.[653]

7.46 Article 23 interdicts, thus, more than action in specific disputes, it also provides discipline for the general process WTO Members must follow when seeking redress of WTO inconsistencies. A violation of the explicit provisions of Article 23 can, therefore, be of two different kinds. It can be caused

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649. Article XVI:4 goes a step further than Article 27 of the Vienna Convention. Article 27 of the Vienna Convention provides that "[a] party may not invoke the provisions of its internal law as justification for its failure to perform a treaty". Article XVI:4, in contrast, not only precludes pleading conflicting internal law as a justification for WTO inconsistencies, but requires WTO Members actually to ensure the conformity of internal law with its WTO obligations.

650. Panel Reports on Argentina - Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items ("Argentina - Textiles and Apparel (US)"), WT/DS56/R (complaint by US), adopted 22 April 1998, paras. 6.45-47 (see also Appellate Body Report, WT/DS56/AB/R, paras. 48-55); Canada - Aircraft, op. cit., paras. 9.124 and 9.208, Turkey - Restrictions on Imports of Textile and Clothing Products, WT/DS34/R, circulated to Members on 31 May 1999 (appealed on other grounds), para. 9.37.

651. Article 23.2(a), in contrast, prohibiting Members from making certain determinations, is not covered elsewhere in the DSU.

652. One could refer, for example, to the requirement to request consultations pursuant to Article 4 of the DSU before requesting a panel under Article 6.

653. Not notifying mutually agreed solutions to the DSB as required in Article 3.6 of the DSU or not abiding by the requirements for a request for consultations or a panel as elaborated in Articles 4 and 6 are some other examples of conduct that would be contrary to DSU rules and procedures but is not mentioned specifically in Article 23.2.

(a) by an ad hoc, specific action in a given dispute, or

(b) by measures of general applicability, e.g. legislation or regulations, providing for a certain process to be followed which does not, say, include recourse to the DSU dispute settlement system or abide by the rules and procedures of the DSU.

(b) Legislation which violates Article 23 of the DSU

. . .

7.48 [T]o give an extreme example, legislation mandating the making of a determination of inconsistency as soon as a WTO panel has issued its report–without awaiting the result of a possible appeal and the adoption of DSB recommendations–would violate Article 23.2(a).

7.49 How, then, should we evaluate Section 304 the statutory language of which mandates in some cases the making of a determination prior to exhaustion of DSU proceedings and which reserves to the USTR the right when exercising this mandatory duty to make a unilateral determination of inconsistency?

7.50 We first find that if the USTR were to exercise, in a specific dispute, the right thus reserved for him or her in the statutory language of Section 304 and make a determination of inconsistency, the US conduct would meet the different elements required for an individual breach under Article 23.2(a).[654] However, Section 304 does

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654. We consider that if the USTR were to exercise, in a specific dispute, the right reserved to him or her under the statutory language of Section 304 to make a determination of inconsistency before exhaustion of DSU procedures, the US conduct would meet the different elements required for a breach of Article 23.2(a) in a specific instance. This conclusion is of crucial importance since it shows that the statutory language of Section 304 reserves the right to the USTR to breach at least the first type of obligations in Article 23.2(a) in a specific instance. Four elements must be satisfied for a specific act in a particular dispute to breach Article 23.2(a):

(a) the act is taken "in such cases" (*chapeau* of Article 23.2), i.e. in a situation where a Member "seek[s] the redress of a violation of obligations or other nullification or impairment of benefits under the covered agreements or an impediment to the attainment of any objective of the covered agreements", as referred to in Article 23.1;

(b) the act constitutes a "determination";

(c) the "determination" is one "to the effect that a violation has occurred, that benefits have been nullified or impaired or that the attainment of any objective of the covered agreements has been impeded";

(d) the "determination" is either not made "through recourse to dispute settlement in accordance with the rules and procedures of [the DSU]" or not made "consistent with the findings contained in the panel or Appellate Body report adopted by the DSB or an arbitration award rendered under [the DSU]". The two elements of this requirement are cumulative in nature. Determinations are only allowed when made through recourse to the DSU and consistent with findings adopted by the DSB or an arbitration award under the DSU.

Applying these four elements to the specific determination allowed under the statutory language of Section 304, namely a determination of inconsistency before exhaustion of DSU procedures we note, first, the parties' agreement that all Section 304 determinations are made in cases where the US is seeking the redress of WTO inconsistencies, in the sense of the first element outlined above. We agree. Obviously, when pursuing a matter of US rights under the WTO through Section 302 investigations, WTO consultations and procedures, and making a decision on whether US rights under the WTO are being denied under Section 304, the US is seeking redress of what it considers to be WTO inconsistencies.

Both parties also agree that determinations under Section 304 meet the second of the four elements, a determination in the sense of Article 23.2(a). We agree. Some of the relevant dictionary meanings of the word "determination" in the context of Article 23.2(a) are: "the settlement of a suit or controversy by the authoritative decision of a judge or arbiter; a settlement or decision so made, an authoritative opinion ... the action of coming to a decision; the result of this; a fixed intention" (The New Shorter Oxford English Dictionary, Ed. Brown, L., Clarendon Press, Oxford, Vol. 1, p. 651). Without there being a need precisely to define what a "determination" in the sense of Article 23.2(a) is, we consider that - given its ordinary meaning - a "determination" implies a high degree of firmness or immutability, i.e. a more or less final decision by a Member in respect of the WTO consistency of a measure taken by another Member.

Given that Article 23.2(a) only deals with "determinations" in case a Member is seeking redress of WTO inconsistencies, we are of the view that a "determination" can only occur subsequent to a Member having decided that, in its preliminary view, there may be a WTO inconsistency, i.e. only once that Member has decided to seek redress of such inconsistency. Mere opinions or views expressed before that stage is reached, are not intended to be covered by Article 23.2(a). However, once a Member does bring a case under the DSU, in particular once it requests the establishment of a panel, one can assume that this preliminary stage has been passed and the threshold of a "determination" met. Such reading of the term "determination" is confirmed by the exception provided for "determinations" made "through recourse to dispute settlement in accordance with" the DSU, an exception that explicitly allows for the "determination" implicit in pursuing a case before a panel. In any event,

not mandate the USTR to make a determination of inconsistency in violation of Article 23 in each and every specific dispute; it merely sets out in the statutory language itself that the USTR has the power and right to do so. The question here is whether this constitutes a breach of the second type of obligations under Article 23, namely a breach by measures of general applicability such as a general law.

7.51 The parties focused much of their arguments on the kind of legislation which could be found to be inconsistent with WTO obligations. The US submitted forcefully that only legislation mandating a WTO inconsistency or precluding WTO consistency, can, as such, violate WTO provisions. This was at the very heart of the US defence. On this US reading it followed that since Section 304 never mandates a specific determination of inconsistency prior to exhaustion of DSU proceeding nor, in the US view, precludes the US from acting consistently with its WTO obligations in all circumstances, the legislation, in and of itself could not be in violation of Article 23.2(a) of the DSU.

7.52 The EC submitted with equal force that also certain types of legislation under which a WTO inconsistent conduct is not mandated but is allowed, could violate WTO obligations. The EC considered that Section 304 is of such a nature.

7.53 Despite the centrality of this issue in the submissions of both parties, we believe that resolving the dispute as to which type of legislation, in abstract, is capable of violating WTO obligations is not germane to the resolution of the type of claims before us. In our view the appropriate method in cases such as this is to examine with care the nature of the WTO obligation at issue and to evaluate the Measure in question in the light of such examination. The question is then whether, on the correct interpretation of the specific WTO obligation at issue, only mandatory or also discretionary national laws are prohibited. We do not accept the legal logic that there has to be one fast and hard rule covering all domestic legislation. After all, is it so implausible that the framers of the WTO Agreement, in their wisdom, would have crafted some obligations which would render illegal even discretionary legislation and crafted other obligations prohibiting only mandatory legislation?[658] Whether or not Section 304 violates Article

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what is decisive under Article 23.2(a) is not so much whether an act constitutes a "determination"–in our view, a more or less formal requirement that needs broad reading–but whether it is consistent with DSU rules and procedures, the fourth element discussed below.

On that basis, we find that USTR determinations under Section 304–made subsequent to internal investigations, WTO consultations and proceedings, if applicable; and, in the case of determinations of inconsistency, automatically and as a conditio since qua non leading to a decision on action under Section 301–meet the threshold of firmness and immutability required for a "determination" under Article 23.2(a).

The third element under Article 23.2(a) as applied to the specific determination under examination is also satisfied. We recall that this determination would be one finding that US rights under the WTO have been denied, i.e. a determination "to the effect that a violation has occurred, that benefits have been nullified or impaired or that the attainment of any objective of the covered agreements has been impeded", thus meeting the third element under Article 23.2(a).

The fourth element under Article 23.2(a) is likewise satisfied. We recall that the specific determination under examination here would be one made before DSB findings on the matter have been adopted. It would thus not be made "through recourse to dispute settlement in accordance with the rules and procedures of [the DSU]" nor made "consistent with the findings contained in the panel or Appellate Body report adopted by the DSB". Indeed, such determination made before exhaustion of DSU procedures, would not be required, referred to or relevant for any of the steps or procedures in the DSU. On the contrary, it would be a determination that, at face value, prejudices and could even contradict the outcome of DSU procedures. Moreover, any such determination could not be consistent with DSB findings, since no such findings would, as yet, be adopted.

In conclusion, if the USTR were to exercise, in a specific dispute, the right reserved for it in Section 304 to make a determination of inconsistency before exhaustion of DSU procedures, the US conduct would meet all four elements required for a breach of Article 23.2(a).

658. Imagine, for example, legislation providing that all imports, including those from WTO Members, would be subjected to a customs inspection and that the administration would enjoy the right, at its discretion, to impose on all such goods tariffs in excess of those allowed under the schedule of tariff concessions of the Member concerned. Would the fact that under such legislation the national administration would not be mandated to impose tariffs in excess of the WTO obligation, in and of itself exonerate the legislation in question? Would such a conclusion not depend on a careful examination of the obligations contained in specific WTO provisions, say, Article II of GATT and specific schedule of concessions?

23 depends, thus, first and foremost on the precise obligations contained in Article 23.

7.54 We can express this view in a different way:

> (a) Even if we were to operate on the legal assumption that, as argued by the US, only legislation mandating a WTO inconsistency or precluding WTO consistency, can violate WTO provisions; and
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> (b) confirm our earlier factual finding in paragraph 7.31(c) that the USTR enjoys full discretion to decide on the content of the determination,

we would still disagree with the US that the combination of (a) and (b) necessarily renders Section 304 compatible with Article 23, since Article 23 may prohibit legislation with certain discretionary elements and therefore the very fact of having in the legislation such discretion could, in effect, preclude WTO consistency. In other words, rejecting, as we have, the presumption implicit in the US argument that no WTO provision ever prohibits discretionary legislation does not imply a reversal of the classical test in the pre-existing jurisprudence that only legislation mandating a WTO inconsistency or precluding WTO consistency, could, as such, violate WTO provisions. Indeed that is the very test we shall apply in our analysis. It simply does not follow from this test, as sometimes has been argued, that legislation with discretion could never violate the WTO. If, for example, it is found that the specific obligations in Article 23 prohibit a certain type of legislative discretion, the existence of such discretion in the statutory language of Section 304 would presumptively preclude WTO consistency. . . .

7.56 We have already found that under the statutory provisions of Section 304 each time the USTR exercises the mandatory duty to make a determination, the statutory language gives him or her discretion and reserves to him or her the right to make a determination of inconsistency even in cases where DSU proceedings have not been exhausted.

7.57 In our view, the ordinary meaning of the provisions of Article 23, even when read in abstract, supports the position that this aspect of Section 304 constitutes a prima facie violation of DSU rules and procedures. This interpretation of Article 23 is amply confirmed when we consider, as is our duty under the Vienna Convention, the good faith provision in the general rule of interpretation in Article 31 of that Convention, and when we evaluate the terms of Article 23 not in abstract, but in their context and in the light of the DSU's and the WTO's object and purpose.

4. Article 23.2(a) of the DSU interpreted in accordance with the Vienna Convention Rules on Treaty Interpretation

(a) "A treaty shall be interpreted ... in accordance with the ordinary meaning to be given to the terms of the treaty ..."

. . .

7.59 The text of Article 23.1 is simple enough: Members are obligated generally to (a) have recourse to and (b) abide by DSU rules and procedures. These rules and procedures include most specifically in Article 23.2(a) a prohibition on making a unilateral determination of inconsistency prior to exhaustion of DSU proceedings. As a plain textual matter, therefore, could it not be said that statutory language of a Member specifically authorizing a determination of inconsistency prior to exhaustion of DSU procedures violates the ordinary meaning of Members' obligations under Article 23?

7.60 Put differently, cannot the raw text of Articles 23.2(a) and 23.1 be read as constituting a mutual promise among WTO members giving each other a guarantee enshrined in an international legal obligation, that certain specific conduct will not take place? Does not the text of Article 23.1 in particular suggest that this promise has been breached and the guarantee compromised when a Member puts in place legislation which explicitly allows it to do that which it promised not to do?

7.61 On this reading, the very discretion granted under Section 304, which under the US argument absolves the legislation, is what, in our eyes, creates the presumptive violation. The statutory language which gives the USTR this discretion on its face precludes the US from abiding by its obligations under the WTO. In each and every case when a determination is made whilst DSU proceedings are not yet exhausted, Members locked in a dispute with the US will be subject to a mandatory determination by the USTR under a statute which explicitly puts them in that very danger which Article 23 was intended to remove.[660]

7.62 It could be said that this is a danger which can never be entirely removed. After all, even those Members which do not have any internal "trade legislation" can any day of the week decide to violate their WTO obligations including the obligations under Article 23.

7.63 In our view, when a WTO Member has not enacted specific legislation providing for procedures to enforce WTO rights, normally only the first type of violation of Article 23 can occur, i.e. a breach of the promise not to make determinations of inconsistency before the adoption of DSB findings in specific disputes. Certain WTO Members, however, including the US and the EC, have enacted legislation for seeking redress of WTO inconsistencies. There can be very good reasons related to norms of transparency, democracy and the rule of law which explain why Members may wish to have such legislation. However, when a Member adopts any legislation it has to be mindful that it does not violate its WTO obligations. Trade legislation, important or positive as it may be, which statutorily reserves the right for the Member concerned to do something which it has promised not to do under Article 23.2(a), goes, in our view, against the ordinary meaning of Article 23.2(a) read together with Article 23.1.

(b) "A treaty shall be interpreted in good faith ..."

7.64 It is notoriously difficult, or at least delicate, to construe the requirement of the Vienna Convention that a treaty shall be interpreted in good faith in third party dispute resolution, not least because of the possible imputation of bad faith to one of the parties. We prefer, thus, to consider which interpretation suggests "better faith" and to deal only briefly with this element of interpretation. Applying the good faith requirement to Article 23 may not lead to a conclusive result but impels us in the direction suggested by our examination of the ordinary meaning of the raw text.

7.65 Imagine two farmers with adjacent land and a history of many disputes concerning real and alleged mutual trespassing. In the past, self help through force and threats of force has been used in their altercations. Naturally, exploitation of the lands close to the boundaries suffers since it is viewed as dangerous terrain. They now sign

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660. We reject the notion that this danger is removed by virtue of the international obligation alone. Even in the EC where EC norms may produce direct effect and thus give far greater assurance, an EC Member State is not absolved by this fact from its duty to bring national legislation into compliance with its transnational obligations under, say, an EC directive (Commission v. Belgium, Case 102/79, [1980] European Court Reports 1473 at para. 12 of the judgment).

an agreement under which they undertake that henceforth in any case of alleged trespassing they will abjure self help and always and exclusively make recourse to the police and the courts of law. They specifically undertake never to use force when dealing with alleged trespass. After the entry into force of their agreement one of the farmers erects a large sign on the contested boundary: "No Trespassing. Trespassers may be shot on sight".

7.66 One could, of course, argue that since the sign does not say that trespassers will be shot, the obligations undertaken have not been violated. But would that be the "better faith" interpretation of what was promised? Did they not after all promise always and exclusively to make recourse to the police and the courts of law?

7.67 Likewise, is it a good faith interpretation to construe the obligations in Article 23 to allow a Member that promised its WTO partners–under Articles 23.1 and 23.2(a)–that it will generally, including in its legislation, have recourse to and abide by the rules and procedures of the DSU which specifically contain an undertaking not to make a determination of inconsistency prior to exhaustion of DSU proceedings, to put in place legislation the language of which explicitly, urbi et orbi, reserves to its Executive Branch the right to make a determination of inconsistency–that which it promised it would not do? This Panel thinks otherwise.

7.68 The good faith requirement in the Vienna Convention suggests, thus, that a promise to have recourse to and abide by the rules and procedures of the DSU, also in one's legislation, includes the undertaking to refrain from adopting national laws which threaten prohibited conduct.

7.69 We do not wish to argue that this reading of Article 23 based on the raw text and the good faith consideration referred to in Article 31 of the Vienna Convention, but not yet read in the light of the DSU's and the WTO's object and purpose, is necessarily compelling. It is, however, in our view a perfectly plausible reading. Whilst we reject the US argument which would construe the interdiction in Article 23.2(a) to refer exclusively to actual determinations of inconsistency or legislation mandating such determinations, we do not think that it, too, based on the raw text alone, is implausible.

7.70 Any doubts one might have, however, between these two possible interpretations are dispelled when we consider the other interpretative elements found in Article 31 of the Vienna Convention. For presentational and narrative reasons we will deal with object-and-purpose before we deal with context.

(c) "... the ordinary meaning ... in the light of [the treaty's] object and purpose"

7.71 What are the objects and purposes of the DSU, and the WTO more generally, that are relevant to a construction of Article 23? The most relevant in our view are those which relate to the creation of market conditions conducive to individual economic activity in national and global markets and to the provision of a secure and predictable multilateral trading system. . . .

7.75 Providing security and predictability to the multilateral trading system is another central object and purpose of the system which could be instrumental to achieving the broad objectives of the Preamble. Of all WTO disciplines, the DSU is one of the most important instruments to protect the security and predictability of the multilateral trading system and through it that of the market-place and its different operators. DSU provisions must, thus, be interpreted in the light of this object and purpose and in a manner which would most effectively enhance it. In this respect we are referring not only to preambular language but also to positive law provisions in the DSU itself. [The

panel report quotes from DSU art. 3.2.][661]

7.76 The security and predictability in question are of "the multilateral trading system". The multilateral trading system is, per force, composed not only of States but also, indeed mostly, of individual economic operators. The lack of security and predictability affects mostly these individual operators.

7.77 Trade is conducted most often and increasingly by private operators. It is through improved conditions for these private operators that Members benefit from WTO disciplines. The denial of benefits to a Member which flows from a breach is often indirect and results from the impact of the breach on the market place and the activities of individuals within it. Sections 301-310 themselves recognize this nexus. One of the principal triggers for US action to vindicate US rights under covered agreements is the impact alleged breaches have had on, and the complaint emanating from, individual economic operators.

7.78 It may, thus, be convenient in the GATT/WTO legal order to speak not of the principle of direct effect but of the principle of indirect effect.

7.79 Apart from this name-of-convenience, there is nothing novel or radical in our analysis. We have already seen that it is rooted in the language of the WTO itself. It also represents a GATT/WTO orthodoxy confirmed in a variety of ways over the years including panel and Appellate Body reports as well as the practice of Members.

7.80 Consider, first, the overall obligation of Members concerning their internal legislation. Under traditional public international law a State cannot rely on its domestic law as a justification for non-performance.[662] Equally, however, under traditional public international law, legislation under which an eventual violation could, or even would, subsequently take place, does not normally in and of itself engage State responsibility. If, say, a State undertakes not to expropriate property of foreign nationals without appropriate compensation, its State responsibility would normally be engaged only at the moment foreign property had actually been expropriated in a given instance. And yet, even in the GATT, prior to the enactment of Article XVI:4 of the WTO Agreement explicitly referring to measures of a general nature, legislation as such independent from its application in specific instances was considered to constitute a violation. This is confirmed by numerous adopted GATT panel reports and is also agreed upon by both parties to this dispute. Why is it, then, that legislation as such was found to be inconsistent with GATT rules? If no specific application is at issue–if, for example, no specific discrimination has yet been made–what is it that constitutes the violation?

7.81 Indirect impact on individuals is, surely, one of the principal reasons. In treaties which concern only the relations between States, State responsibility is incurred only

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661. The importance of security and predictability as an object and purpose of the WTO has been recognized as well in many panel and Appellate Body reports. See the Appellate Body report on Japan - Alcoholic Beverages, op. cit., p. 31 ("WTO rules are reliable, comprehensible and enforceable. WTO rules are not so rigid or so inflexible as not to leave room for reasoned judgements in confronting the endless and ever-changing ebb and flow of real facts in real cases in the real world. They will serve the multilateral trading system best if they are interpreted with that in mind. In that way, we will achieve the 'security and predictability' sought for the multilateral trading system by the Members of the WTO through the establishment of the dispute settlement system"). It has also been referred to under the TRIPS Agreement. In the Appellate Body Report on India - Patents (US), op. cit., it was found, at para. 58, that "India is obliged, by Article 70.8(a), to provide a legal mechanism for the filing of mailbox applications that provides a sound legal basis to preserve both the novelty of the inventions and the priority of the applications as of the relevant filing and priority dates". See also the WTO Panel Report on Argentina - Textiles and Apparel (US), op. cit., para. 6.29 and the GATT Panel Reports on United States Manufacturing Clause, adopted 15/16 May 1984, BISD 31S/74, para. 39; Japan - Measures on Imports of Leather ("Japan - Leather"), adopted 15/16 May 1984, BISD 31S/94, para. 55; EEC - Imports of Newsprint, adopted November 20 1984, BISD 31S/114, para. 52; Norway - Restrictions on Imports of Apples and Pears, adopted 22 June 1989, BISD 36S/306, para. 5.6.

662. See Article 27 of the Vienna Convention.

when an actual violation takes place. By contrast, in a treaty the benefits of which depend in part on the activity of individual operators the legislation itself may be construed as a breach, since the mere existence of legislation could have an appreciable "chilling effect" on the economic activities of individuals.

7.82 Thus, Article III:2 of GATT 1947, for example, would not, on its face, seem to prohibit legislation independently from its application to specific products. However, in light of the object and purpose of the GATT, it was read in GATT jurisprudence as a promise by contracting parties not only that they would abstain from actually imposing discriminatory taxes, but also that they would not enact legislation with that effect.

7.83 It is commonplace that domestic law in force imposing discriminatory taxation on imported products would, in and of itself, violate Article III irrespective of proof of actual discrimination in a specific case.[663] Furthermore, a domestic law which exposed imported products to future discrimination was recognized by some GATT panels to constitute, by itself, a violation of Article III, even before the law came into force.[664] Finally, and most tellingly, even where there was no certainty but only a risk under the domestic law that the tax would be discriminatory, certain GATT panels found that the law violated the obligation in Article III.[665] A similar approach was followed in respect of Article II of GATT 1994 by the WTO panel on Argentina - Textiles and Apparel (US) when it found that the very change in system from ad valorem to specific duties was a breach of Argentina's ad valorem tariff binding even though such change only brought about the potential of the tariff binding being exceeded depending on the price of the imported product.[666]

7.84 The rationale in all types of cases has always been the negative effect on

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663. A change in the relative competitive opportunities caused by a measure of general application as such, to the detriment of imported products and in favour of domestically produced products, is the decisive criterion.

664. In the Panel Report on US - Superfund (op. cit., paras. 5.2.1 and 5.2.2) tax legislation as such was found to violate GATT obligations even though the legislation had not yet entered into effect. See also the Panel Report on US - Malt Beverages (op. cit., paras. 5.39, 5.57, 5.60 and 5.69) where the legislation imposing the tax discrimination was, for example, not being enforced by the authorities.

665. See Panel Report on US - Tobacco, op. cit., para. 96:

> The Panel noted that an internal regulation which merely exposed imported products to a risk of discrimination had previously been recognized by a GATT panel to constitute, by itself, a form of discrimination, and therefore less favourable treatment within the meaning of Article III. The Panel agreed with this analysis of risk of discrimination as enunciated by this earlier panel.

A footnote to this paragraph refers to the Panel Report on EEC - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal Feed Protein, adopted 25 January 1990, BISD 37S/86, para. 141, which reads as follows:

> Having made this finding the Panel examined whether a purchase regulation which does not necessarily discriminate against imported products but is capable of doing so is consistent with Article III:4. The Panel noted that the exposure of a particular imported product to a risk of discrimination constitutes, by itself, a form of discrimination. The Panel therefore concluded that purchase regulations creating such a risk must be considered to be according less favourable treatment within the meaning of Article III:4. The Panel found for these reasons that the payments to processors of Community oilseeds are inconsistent with Article III:4.

666. Op. cit., paras. 6.45-6.47, in particular para. 6.46: "In the present dispute we consider that the competitive relationship of the parties was changed unilaterally by Argentina because its mandatory measure clearly has the potential to violate its bindings, thus undermining the security and the predictability of the WTO system". This was confirmed by the Appellate Body (op. cit., para. 53):

> In the light of this analysis, we may generalize that under the Argentine system, whether the amount of the DIEM [a regime of Minimum Specific Import Duties] is determined by applying 35 per cent, or a rate less than 35 per cent, to the representative international price, there will remain the possibility of a price that is sufficiently low to produce an ad valorem equivalent of the DIEM that is greater than 35 per cent. In other words, the structure and design of the Argentine system is such that for any DIEM, no matter what ad valorem rate is used as the multiplier of the representative international price, the possibility remains that there is a "break-even" price below which the ad valorem equivalent of the customs duty collected is in excess of the bound ad valorem rate of 35 per cent.

On that basis, the Appellate Body found that the application of a type of duty different from the type provided for in a Member's Schedule is inconsistent with Article II:1(b), first sentence, of the GATT 1994. In this respect, see also the Panel Report on United States - Standards for Reformulated and Conventional Gasoline, adopted 20 May 1996, WT/DS2/R, para. 6.10.

economic operators created by such domestic laws. An individual would simply shift his or her trading patterns–buy domestic products, for example, instead of imports–so as to avoid the would-be taxes announced in the legislation or even the mere risk of discriminatory taxation. Such risk or threat, when real, was found to affect the relative competitive opportunities between imported and domestic products because it could, in and of itself, bring about a shift in consumption from imported to domestic products: This shift would be caused by, for example, an increase in the cost of imported products and a negative impact on economic planning and investment to the detriment of those products. This rationale was paraphrased in the Superfund case as follows:

> to protect expectations of the contracting parties as to the competitive relationship between their products and those of the other contracting parties. Both articles [GATT Articles III and XI] are not only to protect current trade but also to create the predictability needed to plan future trade.

Doing so, the panel in Superfund referred to the reasoning in the Japanese Measures on Imports of Leather case. There the panel found that an import quota constituted a violation of Article XI of GATT even though the quota had not been filled. It did so on the following grounds:

> the existence of a quantitative restriction should be presumed to cause nullification or impairment not only because of any effect it had had on the volume of trade but also for other reasons e.g. it would lead to increased transaction costs and would create uncertainties which could affect investment plans.[670]

7.85 In this sense, Article III:2 is not only a promise not to discriminate in a specific case, but is also designed to give certain guarantees to the market place and the operators within it that discriminatory taxes will not be imposed. For the reasons given above, any ambivalence in GATT panel jurisprudence as to whether a risk of discrimination can constitute a violation should, in our view, be resolved in favour of our reading.[671]

7.86 Similarly, Article 23 too has to be interpreted in the light of these principles which encapsulate such a central object and purpose of the WTO. It may have been plausible if one considered a strict Member-Member matrix to insist that the obligations in Article 23 do not apply to legislation that threatens unilateral determinations but does not actually mandate them. It is not, however, plausible to construe Article 23 in this way if one interprets it in the light of the indirect effect such legislation has on

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670. Panel Report on Japan - Leather, op. cit., para. 55. In this respect, see also Panel Report on US - Malt Beverages (op. cit., para. 5.60), where legislation was found to constitute a GATT violation even though it was not being enforced, for the following reason:

> Even if Massachusetts may not currently be using its police powers to enforce this mandatory legislation, the measure continues to be mandatory legislation which may influence the decisions of economic operators. Hence, a non-enforcement of a mandatory law in respect of imported products does not ensure that imported beer and wine are not treated less favourably than like domestic products to which the law does not apply.

671. As a result, we do not consider that the general statements made in certain GATT panels are correct in respect of all WTO obligations and in all circumstances, for example, the statement in Panel Report on EEC - Parts and Components (op. cit., para. 5.25) that "[u]nder the provisions of the [GATT] which Japan claims have been violated by the EEC contracting parties are to avoid certain measures; but these provisions do not establish the obligation to avoid legislation under which the executive authorities may possibly impose such measures" and in Panel Report on Thai - Cigarettes (op. cit., para. 84), the statement that "legislation merely giving the executive the possibility to act inconsistently with Article III:2 [of GATT] could not, by itself, constitute a violation of that provision". In respect of this ambivalence in GATT jurisprudence, see Chua, A., *Precedent and Principles of WTO Panel Jurisprudence*, Berkeley Journal of International Law, 1998, p. 171, in particular at p. 193.

individuals and the market-place, the protection of which is one of the principal objects and purposes of the WTO.

7.87 To be sure, in the cases referred to above, whether the risk materialised or not depended on certain market factors such as fluctuating reference prices on which the taxation of the imported product was based by virtue of the domestic legislation. In this case, whether the risk materializes depends on a decision of a government agency. From the perspective of the individual economic operator, however, this makes little difference. Indeed, it may be more difficult to predict the outcome of discretionary government action than to predict market conditions, thereby exacerbating the negative economic impact of the type of domestic law under examination here.

7.88 When a Member imposes unilateral measures in violation of Article 23 in a specific dispute, serious damage is created both to other Members and the market-place. However, in our view, the creation of damage is not confined to actual conduct in specific cases. A law reserving the right for unilateral measures to be taken contrary to DSU rules and procedures, may–as is the case here–constitute an ongoing threat and produce a "chilling effect" causing serious damage in a variety of ways.

7.89 First, there is the damage caused directly to another Member. Members faced with a threat of unilateral action, especially when it emanates from an economically powerful Member, may in effect be forced to give in to the demands imposed by the Member exerting the threat, even before DSU procedures have been activated. To put it differently, merely carrying a big stick is, in many cases, as effective a means to having one's way as actually using the stick. The threat alone of conduct prohibited by the WTO would enable the Member concerned to exert undue leverage on other Members. It would disrupt the very stability and equilibrium which multilateral dispute resolution was meant to foster and consequently establish, namely equal protection of both large and small, powerful and less powerful Members through the consistent application of a set of rules and procedures.

7.90 Second, there is the damage caused to the market-place itself. The mere fact of having legislation the statutory language of which permits conduct which is WTO prohibited–namely, the imposition of unilateral measures against other Members with which it is locked in a trade dispute–may in and of itself prompt economic operators to change their commercial behaviour in a way that distorts trade. Economic operators may be afraid, say, to continue ongoing trade with, or investment in, the industries or products threatened by unilateral measures. Existing trade may also be distorted because economic operators may feel a need to take out extra insurance to allow for the illegal possibility that the legislation contemplates, thus reducing the relative competitive opportunity of their products on the market. Other operators may be deterred from trading with such a Member altogether, distorting potential trade. The damage thus caused to the market-place may actually increase when national legislation empowers individual economic operators to trigger unilateral State action, as is the case in the US which allows individual petitioners to request the USTR to initiate an investigation under Sections 301-310. This in itself is not illegal. But the ability conferred upon economic operators to threaten their foreign competitors with the triggering of a State procedure which includes the possibility of illegal unilateral action is another matter. It may affect their competitive economic relationship and deny certain commercial advantages that foreign competitors would otherwise have. The threat of unilateral action can be as damaging on the market-place as the action itself.

7.91 In conclusion, the risk of discrimination was found in GATT jurisprudence to constitute a violation of Article III of GATT–because of the "chilling effect" it has on

economic operators. The risk of a unilateral determination of inconsistency as found in the statutory language of Section 304 itself has an equally apparent "chilling effect" on both Members and the market-place even if it is not quite certain that such a determination would be made. The point is that neither other Members nor, in particular, individuals can be reasonably certain that it will not be made. Whereas States which are part of the international legal system may expect their treaty partners to assume good faith fulfillment of treaty obligations on their behalf, the same assumption cannot be made as regards individuals.

7.92 It is a circumspect use of the teleological method to choose that interpretation of Article 23 of the DSU that provides this certainty and eliminates the undesired "chilling effects" which run against the object and purpose of the WTO Agreement.

(d) "...in their context..."

7.93 Construing a WTO obligation as prohibiting a domestic law that "merely" exposes Members and individual operators to risk of WTO inconsistent action should not be done lightly. It depends on the specific WTO obligation at issue, the measure under consideration and the specific circumstances of each case. We are, however, confirmed in our view that Article 23 contains such an obligation not only by textual and teleological considerations but also by systemic ones, namely the context of Article 23 and the DSU in the overall WTO system.[673]

7.94 The more effective and quasi-automatic dispute settlement system under the WTO has often been heralded as one of the fundamental changes and major achievements of the Uruguay Round agreements. Because of that, the relevance of Article 23 obligations for individuals and the market-place is particularly important since they radiate on to all substantive obligations under the WTO. If individual economic operators cannot be confident about the integrity of WTO dispute resolution and may fear unilateral measures outside the guarantees and disciplines which the DSU ensures, their confidence in each and every of the substantive disciplines of the system will be undermined as well. The overall systemic damage and the denial of benefits would be amplified accordingly. The assurances thus given under the DSU may, in our view, be of even greater importance than those provided under substantive WTO provisions. For that reason, the preservation of the specific guarantees provided for in Article 23 is of added importance given the spill-over effect they have on all material WTO rights and obligations.

5. Preliminary Conclusion after the Panel's Examination of the Statutory Language of Section 304

7.95 Our textual interpretation of Article 23.2(a) is thus confirmed when taking account also of the other elements referred to in Article 31 of the Vienna Convention.[674]

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673. We realise that the possibility for a Member to breach its obligations under Article 23.2(a) will always remain. In that sense, guarantees can never be completely assured. However, remote possibilities that obligations may be breached, i.e. normal risks to be accepted in all trade relations, should be distinguished from explicit risks or threats created by statute, i.e. where a Member makes it known to all its trade partners that they may be subjected to an internal procedure under which the right to breach WTO obligations is reserved.

674. Since an examination of the elements referred to in Article 31 does not leave the meaning of Article 23.2(a) "ambiguous or obscure" nor leads to a result which is "manifestly absurd or unreasonable" in the sense of Article 32 of the Vienna Convention, we do not need to evaluate the supplementary means of interpretation referred to in Article 32.

Under this reading the duty of Members under Article 23 to have recourse to and abide by the rules and procedures of the DSU and to abstain from unilateral determinations of inconsistency, is meant to guarantee Members as well as the market-place and those who operate in it that no such determinations in respect of WTO rights and obligations will be made.

7.96 Consequently, the statutory language of Section 304–by mandating a determination before the adoption of DSB findings and statutorily reserving the right for this determination to be one of inconsistency–must be considered presumptively to be inconsistent with the obligations in Article 23.2(a). The discretion given to the USTR to make a determination of inconsistency creates a real risk or threat for both Members and individual economic operators that determinations prohibited under Article 23.2(a) will be imposed. The USTR's discretion effectively to make such determinations removes the guarantee which Article 23 is intended to give not only to Members but indirectly also to individuals and the market place. In this sense, the USTR's discretion under Section 304 does not -- as the US argued -- ensure the consistency of Section 304. On the contrary, it is the core element of the prima facie inconsistency of the statutory language of Section 304.

7.97 Therefore, pursuant to our examination of text, context and object-and-purpose of Article 23.2(a) we find, at least prima facie, that the statutory language of Section 304 precludes compliance with Article 23.2(a). This is so because of the nature of the obligations under Article 23. Under Article 23 the US promised to have recourse to and abide by the DSU rules and procedures, specifically not to resort to unilateral measures referred to in Article 23.2(a). In Section 304, in contrast, the US statutorily reserves the right to do so. In our view, because of that, the statutory language of Section 304 constitutes a prima facie violation of Article 23.2(a).[675]

6. The Non-Statutory Elements of Section 304

(a) Introduction and Summary of the Panel's Analysis

7.98 In the previous analysis we have deliberately referred to the "statutory language" of Section 304 and likewise we have deliberately concluded that the statutory language creates a prima facie violation. We did not conclude that a violation has been confirmed. This is so because of the special nature of the Measure in question. The Measure in question includes statutory language as well as other institutional and administrative elements. To evaluate its overall WTO conformity we have to assess all of these elements together.

7.99 Therefore, although we found above that the statutory language of Section 304 creates a prima facie violation of Article 23.2(a), this does not, in and of itself, establish a US violation. There is more to Section 304 than statutory language. Consequently, we have to examine the impact of the other elements on the overall conformity of the

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675. We would like to emphasize again that this finding does not require the wholesale reversing of earlier GATT and WTO jurisprudence on mandatory and discretionary legislation. The classical test under previous jurisprudence was that only legislation mandating a WTO inconsistency or precluding WTO consistency, could, as such, violate WTO provisions. . . . The methodology we adopted was to examine first and with care the WTO provision in question and the obligation it imposed on Members. It could not be presumed, in our view, that the WTO would never prohibit legislation under which a national administration would enjoy certain discretionary powers. If it were found upon such examination that certain discretionary powers were in fact inconsistent with a WTO obligation, then legislation allowing such discretion would, on its face, fail the classical test: it would preclude WTO consistency.

Measure in question with the relevant WTO provisions. . . .

7.104 For the following reasons we find that the prima facie violation has in fact in this case been lawfully removed and no longer exists. . . .

7.106 The statutory language of Section 304 gives the USTR the broad discretion we outlined above as regards the entire scope of US trade relations, only a part of which comes within the orbit of WTO obligations. Within the discretion allowed, the statutory language leaves it to the USTR to apply the provisions of the Trade Act which relate to the entire gamut of US trade relations in a manner which is consistent with US interests and obligations. The interests and obligations can be different from one group of States to another.

7.107 We find, as a matter of fact, that it is within that broad discretion afforded to the US Administration, notably as regards the content of determinations pursuant to Section 304, lawfully to set out different regimes for the application of Section 304 depending on whether or not it concerns WTO covered situations.

7.108 The language of Section 304 allows the existence of multilateral dispute resolution proceedings to be taken into account.[679] It also allows for determinations of inconsistency to be postponed until after the exhaustion of DSU proceedings.[680] This language surely permits the Administration to limit the discretion of the USTR so that no determination of inconsistency would be made before the exhaustion of DSU proceedings. The wide discretion granted as to the content of the determination to be made should be interpreted as including the power of the US Administration to adopt an administrative decision limiting the USTR's discretion in a manner consistent with US international obligations.[681]

7.109 [W]e find that this is precisely the situation in the present case. Briefly, the US Administration has carved out WTO covered situations from the general application of the Trade Act. It did this in a most authoritative way, inter alia, through a Statement of Administrative Action ("SAA") submitted by the President to, and approved by, Congress. Under the SAA so approved "... it is the expectation of the Congress that future administrations would observe and apply the [undertakings given in the SAA]". One of these undertakings was to "base any section 301 determination that there has been a violation or denial of US rights ... on the panel or Appellate Body findings adopted by the DSB".[682] This limitation of discretion would effectively preclude a determination of inconsistency prior to exhaustion of DSU proceedings. The exercise of discretion under the statutory scheme is in the hands of the Administration and it is the Administration which has given this undertaking. We recognize of course that an

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679. Section 304 states that the determination is to be based on "the investigation initiated under section 302 ... and the consultations (and proceedings, if applicable) under section 303". See, in this respect, footnote 649 above.

680. As the US noted . . . "[t]here is nothing in the text of Sections 301-310 which prevents [the USTR from making two determinations in one and the same case] ... While the Trade Representative is required to make a determination within the time frames set forth in that section , nothing prevents her from making additional determinations after that time". . . .

681. We reach this conclusion not least because of the US constitutional principle of construing US domestic law, where possible, in a way that is consistent with US obligations under international law. We accept the US submissions that "[i]n U.S. law, it is an elementary principle of statutory construction that 'an act of Congress ought never to be construed to violate the law of nations if any other possible construction remains'. *Murray v. Schooner Charming Betsy*, 6 U.S. (2 Cranch) 64, 118 (1804). While international obligations cannot override inconsistent requirements of domestic law, 'ambiguous statutory provisions . . . [should] be construed, where possible, to be consistent with international obligations of the United States'. *Footwear Distributors and Retailers of America v. United States*, 852 F. Supp. 1078, 1088 (CIT), *appeal dismissed*, 43 F.3d 1486 (Table) (Fed. Cir. 1994), citing *DeBartolo Corp. v. Florida Gulf Coast Building and Trades Council*, 485 U.S. 568 (1988)".

682. The SAA, as is often the case in trade policy and trade law circles, uses "section 301" as a generic term referring to enforcement procedures under Sections 301-310 more generally. Thus, when referring to "section 301 determinations", we understand this to mean any determination made under Sections 301-310.

undertaking given by one Administration can be repealed by that Administration or by another Administration. But this is no different from the possibility that statutory language under examination by a panel be amended subsequently by the same or another Legislator. The critical question is whether the curtailment of discretion is lawful and effective. This Panel finds that it is. . . .

(c) US Statements before this Panel

. . .

7.115 The international legal relevance of the US commitments in the SAA were confirmed and amplified also in the context of the very proceedings before this Panel. In response to our very insistent questions, the US explicitly, officially, repeatedly and unconditionally confirmed the commitment expressed in the SAA namely that the USTR would "... base any section 301 determination that there has been a violation or denial of U.S. rights under the relevant agreement on the panel or Appellate Body findings adopted by the DSB".

7.116 The US confirmed this for the record during the first meeting with the parties before the Panel. Subsequently, . . . the US stated the following:

> With regard to determinations under Section 304, . . . the Trade Representative is required under Section 304(a)(1) to base a determination of whether agreement rights have been denied on the results of WTO dispute settlement proceedings. Thus, in the event that a dispute settlement panel were to fail to complete its proceedings within the time frames provided for in the DSU and Section 304(a)(2)(A), the Trade Representative would not be able to make a determination that U.S. agreement rights have been denied".

. . .

7.118 Attributing international legal significance to unilateral statements made by a State should not be done lightly and should be subject to strict conditions. Although the legal effects we are ascribing to the US statements made to the DSB through this Panel are of a more narrow and limited nature and reach compared to other internationally relevant instances in which legal effect was given to unilateral declarations, we have conditioned even these limited effects on the fulfilment of the most stringent criteria. A sovereign State should normally not find itself legally affected on the international plane by the casual statement of any of the numerous representatives speaking on its behalf in today's highly interactive and inter- dependant world[692] nor by a representation made in the heat of legal argument on a State's behalf. This, however, is very far from the case before us.

7.119 At this juncture, it is also worth recalling that under Article 11 of the DSU it

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692. In the Nuclear Test case (Australia v. France), the ICJ held that France was legally bound by publicly given undertakings, made on behalf of the French Government, to cease the conduct of atmospheric nuclear tests. The criteria of obligation were: the intention of the state making the declaration that it should be bound according to its terms; and that the undertaking be given publicly. . . . ICJ Reports (1974), p. 253 at pp. 267-271. . . ; see also Nuclear Test case (New Zealand v. France), ICJ Reports (1974), p. 457, at pp. 472-475; Legal Status of Eastern Greenland case, PCIJ Reports, Series A/B, No. 53, where a statement was found to have legal effects even though it was not made publicly but in the course of conversations with the Norwegian Foreign Minister; Nicaragua case (Merits), ICJ Reports (1986), p. 14, at p. 132; Case Concerning the Frontier Dispute, ICJ Reports (1986), p. 554, at pp. 573-574).

In this case, the legal effect of the US statements does not go as far as creating a new legal obligation. Nonetheless we have applied to them the same, and perhaps even more, stringent conditions. Subsequent to the Nuclear test case, some authors criticised giving legal effect to declarations not directed to a specific State or States but expressed erga omnes (see Rubin, A., *The International Legal Effects of Unilateral Declarations*, American Journal of International Law, 1977, p. 1 and Franck, T., *Word Made Law: The Decision of the ICJ in the Nuclear Test Cases*, American Journal of International Law, 1975, p. 612). In this case the US statements had explicit recipients and were made in the context of a specific dispute settlement procedure.

is our duty to "... make an objective assessment of the facts of the case ... and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements". . . .

7.123 We are satisfied that the representatives appearing before us had full powers to make such legal representations and that they were acting within the authority bestowed on them. Panel proceedings are part of the DSB dispute resolution process. It is inconceivable except in extreme circumstances that a panel would reject the power of the legal representatives of a Member to state before a panel, and through the panel to the DSB, the legal position of a Member as regards its domestic law read in the light of its WTO obligations. The panel system would not function if such a power could not be presumed.

7.124 We are equally satisfied, as a matter of fact, that the statements made to us were intended to be part of the record in the full knowledge and understanding that they could, as any other official submission, be made part of our Report; that they were made with the intention not only that we rely on them but also that the EC and the third parties to the dispute as well as all Members of the DSB–effectively all WTO Members–place such reliance on them.

7.125 Accordingly, we find that these statements by the US express the unambiguous and official position of the US representing, in a manner that can be relied upon by all Members, an undertaking that the discretion of the USTR has been limited so as to prevent a determination of inconsistency before exhaustion of DSU proceedings. Although this representation does not create a new international legal obligation for the US–after all the US was already bound by Article 23 in becoming a WTO Member–it clarifies and gives an undertaking, at an international level, concerning aspects of domestic US law, in particular, the way the US has implemented its obligations under Article 23.2(a) of the DSU.

7.126 The aggregate effect of the SAA and the US statements made to us is to provide the guarantees, both direct to other Members and indirect to the market place, that Article 23 is intended to secure. Through the SAA and the US statements, as we have construed them, it is now clear that under Section 304, taking account of the different elements that compose it, the USTR is precluded from making a determination of inconsistency contrary to Article 23.2(a). As a matter of international law, the effect of the US undertakings is to anticipate, or discharge, any would-be State responsibility that could have arisen had the national law under consideration in this case consisted of nothing more than the statutory language. It of course follows that should the US repudiate or remove in any way these undertakings, the US would incur State responsibility since its law would be rendered inconsistent with the obligations under Article 23.

(d) USTR Practice under Section 304

7.127 It is not our task to examine the individual conduct of the US in specific cases. We did, however, examine the practice of the USTR in specific cases as a means of shedding light on the meaning of Sections 301-310. We also considered that the USTR record could be of limited probative value in evaluating the veracity and significance of the SAA and the policy it articulated.

7.128 In support of its position the US made the following submission to the Panel:

> The record shows that the Trade Representative has never once made a Section

304(a)(1) determination that U.S. GATT or WTO agreement rights have been denied which was not based on the results of GATT and WTO dispute settlement proceedings. Not once.

7.129 Given the intense criticism of Sections 301-310 articulated in the submissions of third parties before this Panel, we expressly invited the EC and all third parties to submit to us any evidence of WTO inconsistent conduct by the US corresponding to the complaints of the EC–and, thus, within our terms of reference–that took place since the entry into force of the WTO. One such alleged case was submitted by one of the third parties (Japan - Auto Parts[697]) to which the EC joined two other cases (EC - Bananas III and Argentina - Textiles and Apparel (US)).

7.130 It is not for us to make a conclusive finding in relation to any of these cases, not least Bananas III which is the subject of proceedings before another panel.[698] However, on the face of the record before us, we do not find the evidence submitted to us in this connection sufficient to overturn the US claim of a consistent record of compliance of Section 304 with Article 23.2(a) as invoked by the EC. In any event, we do not consider the evidence before us sufficient to overturn our conclusions regarding Section 304 itself.[699]

7. Summary of the Panel's Analysis and Finding in respect of the EC claim under Section 304

7.131 The overall result of our analysis may be summarized as follows. We found that the statutory language of Section 304 constitutes a serious threat that determinations contrary to Article 23.2(a) may be taken and, in the circumstances of this case, is prima facie inconsistent with Article 23.2(a) read in the light of Article 23.1. We then found, however, that this threat had been removed by the aggregate effect of the SAA and the US statements before this Panel in a way that also removes the prima facie inconsistency and fulfils the guarantees incumbent on the US under Article 23. In the analogy described in paragraph 7.65, the sign "No Trespassing. Trespassers may be shot on

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697. . . . As a result of the US action in this respect, see also United States - Imposition of Duties on Automobiles from Japan under Section 301 and 304 of the Trade Act of 1974 ("Japan - Auto Parts"), WT/DS6 (complaint by Japan), settlement notified to the DSB.

698. See documents under WT/DS165.

699. In Japan - Auto Parts the US was not seeking redress of inconsistencies under the WTO, it was examining, inter alia, whether Japanese acts or policies in this respect were "unreasonable" under Section 301(b). We consider that even if conduct inconsistent with Article 23.2(a) occurred–a matter on which we express no opinion–the kind of inconsistency implicated would be outside our terms of reference since it covers issues not raised in the EC claims before us.

Whether the US violated Article 23 in the Bananas III case is one of the claims subject to separate panel proceedings. Even if the US conduct in response to the alleged implementation of DSB findings by the EC was inconsistent with Article 23.2(a), we note that any determinations made by the US in this respect were made under Section 306–i.e. were determinations on whether implementation of DSB findings took place–not under Section 304 at issue here, i.e. determinations on whether US rights are being denied prior to the issue of implementation arising. The fact that determinations under Section 306 have to be considered, for purposes of, e.g. publication and subsequent action under Section 301, as determinations under Section 304, pursuant to Section 306 (b)(1), does not alter our conclusion. We deal with the EC claim of inconsistency of Section 306 in Section VII.D below.

Finally, in Argentina - Textiles and Apparel (US), the USTR determination was published subsequently to both the lapse of the 18 months time-period referred to in Section 304 and the adoption of DSB findings on the matter. The determination explicitly states that it is based on the findings of the DSB on the matter. We do not consider the fact that the determination was retroactively dated back to 3 April 1998, i.e. the day before the lapse of the 18 months time-period and thereby also a date prior to the adoption of DSB findings on the matter (22 April 1998), to be relevant on the international plane. In our view, when it comes to examining Article 23.2(a), the actual date of the determination and, especially, the basis of the determination's finding are the critical elements. In terms of US obligations to other WTO Members, this case shows that the US waited until the end of DSU procedures before it publicly announced its determination and that the USTR effectively based her findings on the result of the DSU process. The outcome of the DSU process conditioned the content of the USTR determination.

sight" was construed by us as going against the mutual promise made among the neighbours always and exclusively to have recourse to the police and the courts of law in any case of alleged trespassing. Continuing with that analogy, we would find in this case that the farmer has added to the original sign which was erected for all to read another line stating: "In case of trespass by neighbours, however, immediate recourse to the police and the courts of law will be made". We would hold–as we did in this case–that with this addition the agreement has been respected. . . .

D. THE EC CLAIM THAT SECTION 306 IS INCONSISTENT WITH ARTICLE 23.2(a) OF THE DSU

1. Claims and Arguments of the Parties

7.137 Section 306 concerns the follow-up by the USTR to a determination under Section 304 that US rights under the WTO were being denied. When applied to WTO covered situations referred to in the EC claim it presupposes the completion of panel and, as the case may be, Appellate Body proceedings and a ruling by the DSB in favour of the US. Section 306 sets out the procedures under the Trade Act for obtaining DSB authorization for the suspension of concessions when, in the view of the US, another Member has failed adequately to implement the original ruling of the DSB.

7.138 The EC claims that Section 306 (b) requires the USTR to "consider" whether a WTO Member has implemented the recommendations of the DSB and, in the event of non-implementation, to determine what further action to take. The EC claims that this "consideration" constitutes a "determination" in the sense of Article 23 by the USTR on whether the Member concerned has violated US rights under the WTO Agreement. According to Article 23, determinations of inconsistency may not be made prior to exhaustion of DSB proceedings. However, the EC contends, according to Section 306 this specific determination has to be made no later than 30 days after the expiration of the reasonable period of time granted to the losing WTO Member to implement DSB recommendations. In the EC view, any dispute on the question of implementation has to be settled under Article 21.5 of the DSU which provides for referral of the matter to the original panel for a decision within 90 days. Since such referral can take place at the end or even after the lapse of the reasonable period of time, the EC contends, Section 306 (b) requires a unilateral determination on compliance without awaiting the results of a WTO proceeding under Article 21.5 in violation of Article 23.2(a).

7.139 The US responds that Section 306 does not require the USTR to make a "determination" in violation of Article 23.2(a) of the DSU. In the US view, for the USTR to assert US rights under Article 22 of the DSU, the USTR is not only permitted, but is affirmatively required to make a judgment on–i.e. to "consider", the word used in Section 306 (b) itself–whether implementation of DSB recommendations has taken place. According to the US, a Member wanting to suspend concessions under Article 22 has to request authorization from the DSB within 30 days after the lapse of the reasonable period of time. If not, it loses the right to obtain such authorization by negative consensus. Since, therefore, a winning Member has to formulate its request for authorization within 30 days–even if, subsequently, the matter is referred to arbitration and authorization is only granted thereafter–the US argues that Article 22 itself presupposes that the USTR indicate how it intends to suspend concessions within this 30 day deadline. This 30 day deadline has been transposed into Section 306 (b) and is, therefore, in the view of the US, consistent with Article 23.2(a).

7.140 In respect of the possible conflict between the 30 day period in Section 306 (b) and the 90 day time-limit for a ruling on implementation under Article 21.5, the US argues that recourse to and completion of Article 21.5 proceedings is not a prerequisite for a request for authorization to suspend concessions to be made whenever disagreement arises on implementation. [The panel quoted DSU arts. 21.5-21.6.] . . .

2. Preliminary Panel Findings in respect of the Statutory Language of Section 306

7.142 We propose to adopt here a similar methodology as the one we employed in our examination of Section 304 and examine first the statutory language of Section 306 in the light of US obligations under Article 23.2(a) read in the light of Article 23.1.

7.143 To facilitate the understanding of our subsequent findings, it may be useful to read Section 306 as consisting of two phases. A first phase deals with a "consideration" by the USTR that "a foreign country is not satisfactorily implementing a measure or agreement" (Section 306(b)(1)) or, as repeated in Section 306(b)(2), a "consideration" that "the foreign country has failed to implement". A second phase addresses the "determination" by the USTR on "what further action the Trade Representative shall take under section 301" (Section 306(b)(1)).

7.144 The second phase contains a mandatory element: the determination on the proposed action has to be made, according to Section 306, no later than 30 days after the expiration of the reasonable period of time given to the other WTO Member to implement DSB findings. This second phase can only be activated when the "consideration" in the first phase is made, i.e. when the USTR considers that implementation has failed. Ipso facto, the first phase as well has to take place within the 30 day time-frame prescribed for the second phase. We find, therefore, as a matter of fact, that Section 306 mandates the USTR to "consider" whether or not the WTO Member concerned has implemented DSB recommendations within 30 days after the lapse of the reasonable period of time.

7.145 We also find that the EC is correct in claiming that in certain circumstances this "consideration" by the USTR will necessarily take place before the completion of Article 21.5 procedures on implementation. The usual deadline for completion of procedures under Article 21.5 is 90 days after referral of the matter to the original panel. Article 21.5 does not further specify when and how such referral has to take place nor does it include a deadline for parties to invoke Article 21.5. On these grounds, it is reasonable to assume that situations can occur where Article 21.5 is invoked later than 60 days before the expiration of the reasonable period of time. As a result, the deadline for completion of the panel's work under Article 21.5 could fall later than the 30 superth day after the lapse of the reasonable period of time, the trigger referred to in Section 306 (b). In that event, the "consideration" required under Section 306 would thus need to be taken before the completion of Article 21.5 procedures.

7.146 We further find that USTR "considerations" under the first phase of Section 306–made subsequent to, and based on, internal monitoring by the USTR pursuant to Section 306 (a); and, in the case of a "consideration" that implementation failed, automatically and as a conditio sine qua non leading to a decision on action under Section 301–meet the threshold of firmness and immutability required for a "determination" under Article 23.2(a). Hereafter we thus refer to these "considerations" as

"determinations".[703] The US argument that the first phase of Section 306 is affirmatively required under Article 22 and represents no more than a belief necessary to the pursuit of dispute settlement procedures is, in our view, relevant not so much to the question of whether there is a "determination" but to the question of whether such "determination" is allowed under Article 23.2(a) since made "through recourse to dispute settlement in accordance with the rules and procedures" of the DSU, another element under Article 23.2(a) discussed below. We recall also that the USTR view under Section 306 that implementation failed is not a preliminary one that requires further confirmation by a panel but one referred to the DSB for immediate authorization to suspend concessions (unless an objection is raised against the level of suspension or the principles or procedures followed in considering what concessions to suspend).

7.147 We further find, as a matter of fact, that although the USTR is obligated to make this determination within the 30 day time-frame, it has wide discretion as to the content of this determination. Specifically, we find that there do not exist any circumstances which would compel the USTR under the statutory language of Section 306 to determine that implementation has failed, i.e. to make a determination of inconsistency, whilst Article 21.5 procedures are still pending. In other words, it would always be open to the USTR under the Trade Act to determine that implementation has not failed so long as DSB procedures have not been exhausted. However, as in the case of Section 304, within the discretion created by the statutory language the USTR is not precluded by the statute from making such a determination.

7.148 It is important to note, however, that the determination at issue here, in WTO covered situations, is only a preliminary step under Section 306 to seek DSB authorization for the suspension of concessions or other obligations The result of this determination is not the suspension of concessions without DSB authorization but a request–albeit, according to the EC, a premature one–for authorization from the DSB to impose such suspension.

3. US obligations under Article 23.2(a) of the DSU as applied to Section 306

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7.151 In the case of Section 306 we have already found that . . . the statutory language reserves the right to the USTR to consider that implementation has failed, i.e. to make a determination of inconsistency prior to termination of Article 21.5 proceedings. However, before we conclude that statutory language which reserves this right amounts to a prima facie violation we need to decide whether such a determination in a specific case amounts to a violation. Unlike Section 304, in the case of Section 306 this issue is highly contentious and far from clear. Only if we find, as a matter of law, that Article 23.2(a) is violated when the USTR determines, in a specific case, that implementation has failed in the sense of Section 306 before the completion of Article 21.5 proceedings–as a prelude to seeking DSB authorization for the suspension of

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703. Recalling the four elements required for there to be a breach of Article 23.2(a) in respect of specific acts taken in a given dispute, outlined above in footnote 657, we thus find that "considerations" under Section 306 are "determinations" in the sense of the second element under Article 23.2(a). We also find that determinations under Section 306 meet the first element under Article 23.2(a). The US is obviously seeking redress of WTO inconsistencies when it monitors the implementation of DSB findings under Section 306. The third element concerns the question as to whether the determination under Section 306 is one "to the effect that a violation has occurred ...". Examining specifically the determination at issue here, the one statutorily reserved in Section 306, i.e. the determination that implementation did not take place, in other words, that implementing measures are not consistent with WTO rules even though Article 21.5 procedures have not yet been completed, we hold the view that such determination is one of inconsistency meeting the third element under Article 23.2(a).

concessions–will we be able to find that statutory language in and of itself, which reserves the right to make such a determination, is WTO inconsistent.

7.152 Reading Section 306 in the light of US obligations under Article 23.2(a), the question arises, more particularly, whether determinations under Section 306 are made "through recourse to dispute settlement in accordance with the rules and procedures of [the DSU]" and made "consistent with the findings contained in the panel or Appellate Body report adopted by the DSB or an arbitration award rendered under [the DSU]".[706] These two elements referred to in Article 23.2(a) are cumulative in nature. Determinations are only allowed when made through recourse to the DSU and consistent with findings adopted by the DSB or an arbitration award under the DSU.

7.153 In our view, this question goes to the core of the EC claim under Section 306. As noted earlier, the US maintains that determining that implementation has failed as a prelude to a request for authorization to suspend concessions even prior to the completion of Article 21.5 proceedings is mandated by Article 22. The EC contests this.

7.154 In accordance with our terms of reference, our mandate is to examine whether Section 306 conforms with Article 23.2(a). If we are able to discharge this mandate without seeking to resolve the altogether separate dispute on the correct interpretation of Articles 21.5 and 22 and the relationship between them, the subject of negotiations in the context of the DSU review, we should do so. Thus, this Panel should decide on the correct interpretation of Articles 21.5 and 22 and the relationship between them, only if it is legally indispensable.

7.155 We will, therefore, examine the conformity of Section 306 with Article 23.2(a) on the assumption, first, that the US view on Articles 21.5 and 22 is correct and, then, on the alternative assumption that the EC view in this respect is the correct one.

(a) Assuming the US view is correct

7.156 The US maintains that a proposal for suspension of concessions has to be submitted to the DSB within a 30 days time-frame and that, consequently, the US is obligated to determine that implementation has failed within that time-frame. The US view is based on the following reading of Article 22.

7.157 Article 22.6 states that the DSB "shall grant authorization to suspend concessions or other obligations within 30 days of the expiry of the reasonable period of time unless the DSB decides by consensus to reject the request" . . . or an objection to such request is raised and referred to arbitration. Article 22 thus provides an explicit time-limit for DSB authorization to be requested and granted, at least by virtue of negative consensus. Article 22 and Article 23 do not explicitly refer to Article 21.5. A fortiori nowhere is reference to Article 22 explicitly limited to cases where Article 21.5 has not been invoked.

7.158 Under this reading the US would effectively be obligated under Article 22 to make a determination on whether implementation took place within the time-frame prescribed in Section 306 if it is to benefit from the negative consensus rule. If not, the practice of positive consensus being reactivated, DSB authorization would only be obtained in case all Members, including the defending Member, agree.

7.159 Following the US approach, any determination made under Section 306 in the

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706. As outlined in footnote 657, the determination statutorily reserved in Section 306 meets the first three elements for there to be a breach of Article 23.2(a) in a given dispute. The crucial question to be dealt with here remains, however, whether such determination also meets the fourth element under Article 23.2(a). In this respect see footnote 657.

circumstances referred to in the EC claim would be consistent with Article 23.2(a) since it would be made "through recourse to dispute settlement in accordance with the rules and procedures of [the DSU]", in particular Article 22 thereof. The determination would then not be made as a unilateral act in pursuit of redress, but as an act required when seeking multilateral authorization for the suspension of concessions as provided for in the DSU itself.

7.160 On this reading, the question then arises whether the determination of non-implementation made through recourse to the DSU is also one "consistent with the findings contained in the panel or Appellate Body report adopted by the DSB or an arbitration award rendered under [the DSU]", in the sense of the second phrase of Article 23.2(a). If we consider this to be a reference to the findings of the panel or Appellate Body in the original dispute, then also this requirement would be met. The USTR determination of non-implementation would, indeed, follow and be based on the original findings of inconsistency with WTO rules as adopted by the DSB in respect of the original complaint.

7.161 Could the findings referred to in Article 23.2(a) be regarded, in the specific circumstances under the EC claim, as the findings of the panel examining implementation in the pending Article 21.5 procedures rather than the findings of the original panel? If this were so, one would have to conclude that–since Article 21.5 procedures would still be pending–no such findings would have been adopted. The determination would then be contrary to Article 23.2(a). In our view this does not constitute a plausible interpretation of Article 23.2(a) if we assume the US reading of Article 22 is correct.

7.162 As noted earlier, the determination would be one required under Article 22 in order to maintain the reversed consensus rule. Because of that, it would also be conduct required or at least authorized under Article 23.2(c), obliging Members to "follow the procedures set forth in Article 22 to determine the level of suspension of concessions or other obligations and obtain DSB authorization". There would then be a conflict between Article 23.2(a) and Article 23.2(c). Such conflict could be avoided by adopting the interpretation that the findings referred to in Article 23.2(a) are those of the original panel, not those of the Article 21.5 panel. For these reasons, and assuming the US approach is correct, we do not find that, in the circumstances at hand, the findings referred to in Article 23.2(a) are those of the panel under Article 21.5.

7.163 On these grounds, we find that if the US reading of Article 22 is correct, a determination, in a specific case, that implementation has failed pursuant to Section 306 as a prelude to a request for suspension of concessions in the circumstances referred to in the EC claim, could not be found to be inconsistent with Article 23.2(a) of the DSU. Consequently, the legislation authorizing such a determination would not be in violation either.

(b) Assuming the EC view is correct

7.164 The EC view that Article 22 can only be activated once Article 21.5 procedures have been completed is based on the following reading of the relevant provisions. Article 21.5 states that "[w]here there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply"–and in the circumstances referred to under the EC claim there is such disagreement–"such dispute shall be decided through recourse to these dispute settlement procedures". This arguably implies that in case of disagreement on implementation, Article 21.5 must be pursued, not Article 22. Moreover, Article 22.6 only applies "[w]hen the situation described in paragraph 2

occurs", i.e. in the event "the Member concerned fails to bring the measure found to be inconsistent with a covered agreement into compliance". Since, in the circumstances under examination, an Article 21.5 procedure is pending to make a decision on this very issue, it could be argued that as long as that procedure has not been completed, the conditions for a request for suspension of concessions under Article 22.6 are not fulfilled. Following this line of reasoning, pending Article 21.5, Article 22 cannot be invoked.[709]

7.165 Thus, following the EC approach, a Section 306 determination of non-implementation made, in a specific case, before the completion of Article 21.5 proceedings would be contrary to Article 23.2(a) because it would, in the EC view, not be made "through recourse to dispute settlement in accordance with the rules and procedures of [the DSU]", more particularly, made inconsistently with Articles 21.5 and 22. However, as we have already found, the statutory language of Section 306 mandates the USTR to make a determination within 30 days even if Article 21.5 procedures have not been completed and reserves for the USTR the discretion to make determinations of non-implementation that are–on EC reading–contrary to Article 23.2(a). As a result we consider that–assuming the EC position is correct and for the reasons explained in our examination of the EC claim under Section 304–the statutory language of Section 306, independently from its application in specific disputes, would prima facie violate US obligations under Article 23.2(a).

7.166 As explained earlier, this would be so because of the nature of the US obligations under Article 23. Under Article 23 the US promised not to resort to unilateral measures referred to in Article 23.2(a). However, in Section 306–assuming that the reading of the EC of Articles 21.5 and 22 is correct–the US statutorily reserved the right to do exactly that.

7.167 However, even if we were to find such prima facie violation, it would be removed after consideration of the other elements under Section 306. For the reasons given above, we would then find that the cumulative effect of the US undertakings in the SAA and the statements made by the US to the DSB through this Panel, is effectively and lawfully to curtail the discretion under Section 306 which would be at the source of the prima facie violation of Article 23.2(a).[713] These undertakings would, indeed, fulfill the guarantees received by other WTO Members and, through them, economic operators in the market-place under Article 23.

7.168 Whatever the outcome of other pending panel proceedings, on which we have no view, the fact that the USTR did make a determination of non-implementation before the completion of Article 21.5 procedures in Bananas III, even if it turns out eventually that this was illegal, is not, in our view, an act of bad faith. It was based on the US interpretation given to Articles 21.5 and 22, an interpretation shared by other Members and now subject to negotiation. It seems to this Panel that the US attitude in this respect

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709. In this respect, we note that in another dispute, Australia - Subsidies Provided to Producers and Exporters of Automotive Leather ("Australia - Leather", WT/DS126/R, adopted 16 June 1999, not appealed), the US invoked Article 21.5 but agreed with the defending party, Australia, to await completion of Article 21.5 proceedings before requesting authorization to suspend concessions. With reference to footnote 6 to Article 4 of the SCM Agreement both parties agreed "that the deadline for DSB action under the first sentence of Article 22.6 of the DSU shall be 60 days after the circulation of the review panel report under Article 21.5 of the DSU, and that the deadline specified in the third sentence of Article 22.6 of the DSU for completion of arbitration shall be 45 days after the matter is referred to arbitration" (WT/DS126/8, p. 2).

713. In this respect, . . . the statutory language of Section 306 allows the USTR to await the completion of DSU procedures, including Article 21.5 procedures, before making a determination of inconsistency under Section 306. As to the lawfulness of taking account of result of Article 21.5 proceedings, Section 306 determinations have to be made "on the basis of the monitoring carried out" under Section 306 (a). Such monitoring may include reference to Article 21.5 proceedings.

was due in large measure to the contradictory drafting of Articles 21.5 and 22 and may, as a result, be defensible as an act taken in order to safeguard its right to obtain DSB authorization to suspend concessions by negative consensus.[714] This Panel has no basis on which it could doubt that if as a result of these negotiations or the Bananas III dispute resolution procedures, the EC view in relation to Articles 21.5 and 22 turns out to be correct, the US would honour its undertakings to respect DSU procedures also under Section 306. Indeed, once US obligations on this matter would thus be clear and the EC view in this respect be confirmed, the overriding commitment made by the US Administration to follow and await the completion of DSU procedures before making determinations under Section 306 would be activated. . . .[715]

E. THE EC CLAIM THAT SECTIONS 305 AND 306 ARE INCONSISTENT WITH ARTICLE 23.2(c) OF THE DSU

1. Introduction

7.171 The EC claims that Section 306 (b) is inconsistent with Article 23.2(c) of the DSU because it requires the USTR to determine within 30 days after the expiration of the reasonable period of time what further action to take under Section 301 in case of a failure to implement DSB recommendations. The EC also claims that Section 305(a)(2) is inconsistent with Article 23.2(c) of the DSU because it requires the USTR to implement the action determined earlier under Section 306 within 60 days after the expiration of the reasonable period of time.

7.172 . . . Article 23.2(c) . . . includes two cumulative obligations:

> (a) the US has to "follow the procedures set forth in Article 22 to determine the level of suspension of concessions or other obligations"; and
>
> (b) the US has to "obtain DSB authorization in accordance with those procedures before suspending concessions or other obligations under the covered agreements in response to the failure of the Member concerned to implement the recommendations and rulings within that reasonable period of time".

. . .

2. The EC claim in respect of Determinations on Action under Section 306(b)

7.174 Whereas the previous EC claim dealt with the "consideration" that implementation had failed under Section 306, this claim concerns the subsequent determination on

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714. We note that at least one other WTO Member recently acted in a similar way. In Australia - Salmon, Canada as well requested DSB authorization to suspend concessions within the 30 days framework even though there was disagreement as to whether Australia had implemented DSB recommendations and a panel under Article 21.5 is now examining this disagreement. In Australia - Salmon, Canada took an approach similar to that of the US in order to preserve its rights under Article 22. . . .

On the other hand, see the sequence and procedures agreed upon in Australia - Leather, set out in footnote 709.

715. We realize that as a result it is still unclear whether the USTR is now (1) as the US argues, required to make determinations of inconsistency under Section 306 even pending Article 21.5 procedures in order to preserve US rights under Article 22 or (2) as the EC argues, prohibited under Article 23.2(a) to make such determinations until the completion of Article 21.5 procedures. We stress, however, that our task was to examine the compatibility of US law as such and not its application in a specific dispute, i.e. not whether in a given dispute the USTR is allowed to make this or that determination. Under either hypothesis–the US or the EC approach–we found that Section 306 is not inconsistent with Article 23.2(a). This is now clearly established. Only the way Section 306 should be applied in a specific dispute–an issue not falling within our mandate–is left open.

action following such a determination of non-implementation. At issue here is the second phase of Section 306 as outlined above. We recall that this determination has to be made within 30 days after the expiry of the reasonable period of time and that, in the circumstances referred to by the EC, it may, indeed, be mandated before the completion of Article 21.5 procedures on implementation.

7.175 We find, as a matter of fact, that this determination on what action to take under the second phase of Section 306 is only mandated if the USTR has determined under the first phase that implementation failed.

7.176 As we did in respect of the previous claim, we will examine the conformity of Section 306 with Article 23.2(c) on the assumption, first, that the US view on Articles 21.5 and 22 is correct and, then, on the alternative assumption that the EC view in this respect is the correct one.

7.177 We recall that if one were to accept the US view on the relationship between Articles 21.5 and 22, then the US would effectively be obligated, or at least authorized, under Article 22–in the event it determines that implementation failed–to make a determination on what action to take within 30 days after the expiry of the reasonable period of time. If not, it would lose the right to obtain DSB authorization by negative consensus. In that event, any determination on action made under Section 306 in the circumstances referred to in the EC claim would "follow the procedures set forth in Article 22 to determine the level of suspension of concessions or other obligations" and thus be consistent with Article 23.2(c).

7.178 Turning now to the EC view on Articles 21.5 and 22, we found in examining the first phase of Section 306 that–if one were to accept the EC view–discretion to make a determination of non-implementation before the completion of Article 21.5 procedures would be prima facie inconsistent with Article 23.2(a). If such discretion were maintained, it would spill over to the second phase of Section 306 as well. However, we have already found that–assuming the EC view is correct–the discretion afforded to the USTR to make a determination that implementation has failed prior to the exhaustion of DSU proceedings under Article 21.5 would be effectively curtailed by the undertakings given by the US Administration both internally and internationally. So long as the US undertakings are in place, the trigger for the determination of action under the second phase of Section 306 would thus be disabled and any potential violation also of Article 23.2(c) eliminated.[718] Indeed, in these circumstances, any determination on action under the second phase of Section 306 would–as the determination on consistency under the first phase–take place subsequent to the completion of Article 21.5 procedures in accordance with the EC view on Article 22. Any such determination on action would thus "follow the procedures set forth in Article 22 to determine the level of suspension

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718. We note that–in addition to the discretion granted to the USTR under the first phase of Section 306 allowing it to delay a determination of non-implementation–the USTR has also been granted a certain discretion under the second phase of Section 306, as well as under Section 301, allowing it not to determine what action to take until the completion of Article 21.5 procedures. The determination mandated in Section 306 on what action to take refers to "mandatory action" under Section 301 (a). Section 301 (a) itself provides for several exceptions where the USTR is not required to take action. Under this provision, action is not required, inter alia, if the DSB has adopted a report or ruling finding that US rights have not been denied; if the Member concerned is taking satisfactory measures to grant the US rights at issue under the WTO Agreement, including an expression of intention to comply with DSB recommendations; or if, in extraordinary cases, action would have a disproportionate adverse impact on the US economy or cause serious harm to the national security of the US. An additional discretionary element–allowing the USTR to determine that no action is to be taken–is that action under Section 301(a) is subject to "the specific direction, if any, of the President regarding any such action". Even if the existence of the discretion under both phases of Section 306 and under Section 301 were to constitute a prima facie violation, the undertakings given by the US would remove these.

of concessions or other obligations" and be consistent with Article 23.2(c).

7.179 For the reasons outlined above, we find that Section 306–irrespective of whether we accept the US or the EC approach in respect of Articles 21.5 and 22–is not inconsistent with US obligations under Article 23.2(c). . . .

3. The EC claim in respect of Implementation of Action under Section 305

7.180 Similar reasoning applies to the EC claim in respect of Section 305. Any action the USTR determined to take pursuant to Section 306, constituting the suspension of concessions or other obligations under the WTO, has to be implemented within "30 days after the date on which such determination is made" in accordance with Section 305(a)(1). In other words, if the USTR determines to take action within 30 days after the expiry of the reasonable period of time as referred to in Section 306, it will be obligated to implement such action within 60 days after the expiry of the reasonable period of time. We agree with the EC that Article 21.5 and even Article 22.6 arbitration procedures on the level of suspension may not be over within this 60 days period.[720] As a result, Section 305(a)(1) read in isolation may, in certain circumstances, mandate the implementation of action before receiving DSB authorization to do so.

7.181 However, under Section 305 (a)(2) there is discretion to suspend any implementation of action for up to 180 days beyond the 60 days after the expiration of the reasonable period of time. The USTR may do so if it determines, for example, that a delay is "necessary or desirable to obtain United States rights", for example, DSB authorization to suspend concessions.[721] In addition, implementation of action under Section 305 is also subject to "the specific direction, if any, of the President regarding any such action".[722]

7.182 The requirement to implement action within 60 days–unless exceptions are made–even in cases where DSB authorization has not yet been obtained, may constitute a prima facie violation of the US obligation under Article 23.2(c) to "obtain DSB authorization in accordance with [Article 22] procedures before suspending concessions or other obligations". The fact that implementation can be delayed does not, in our view, necessarily meet the US guarantee granted under Article 23.2(c) to all WTO Members

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720. . . . Since Article 21.5 procedures may seemingly start on or about the date of expiry of the reasonable period of time and, as a general rule, take 90 days, it is likely that such procedures would not be completed within the 60 day deadline of Section 305. In respect of Article 22.6 arbitration procedures, we note that Article 22.6 provides that the arbitration has to be completed within 60 days after the expiry of the reasonable period of time, i.e. the time-limit in Section 305. However, even if the arbitration is completed by then, it may take some more time for the DSB to actually authorize the suspension of concessions consistent with the arbitration report. Considering footnote 7 in the Bananas III arbitration report (WT/DS27/ARB), even the completion of arbitration procedures within 60 days is not a certainty: "On the face of it, the 60-day period specified in Article 22.6 does not limit or define the jurisdiction of the Arbitrators ratione temporis. It imposes a procedural obligation on the Arbitrators in respect of the conduct of their work, not a substantive obligation in respect of the validity thereof. In our view, if the time-periods of Article 17.5 and Article 22.6 of the DSU were to cause the lapse of the authority of the Appellate Body or the Arbitrators, the DSU would have explicitly provided so. Such lapse of jurisdiction is explicitly foreseen, e.g. in Article 12.12 of the DSU which provides that 'if the work of the panel has been suspended for more than 12 months, the authority for establishment of the panel shall lapse'".

721. Thus, even if the US view on the relationship between Articles 21.5 and 22 were correct, the USTR could–after having made determinations on WTO consistency and Section 301 action before the completion of Article 21.5 procedures as required, or at least authorized, under its reading of Article 22–still delay the implementation of any such action it may have determined to take until it has obtained DSB authorization to implement such action consistently with Article 23.2(c).

722. We note also that activation of Section 305 is dependent on a determination of action under Section 306 (second phase) and that the determination of action under Section 306 (second phase) is dependent on a "consideration" that implementation has not taken place under Section 306 (first phase). Since the initial trigger of determining that implementation has not taken place would–following the EC view on the relationship between Articles 21.5 and 22–be removed the consequent implementation of action would also be delayed at least until completion of Article 21.5 procedures.

and, through them, economic operators in the market-place, that determinations contrary to Article 23.2(c) will not be made.

7.183 However, even if the existence of such discretion were to constitute a prima facie violation, the undertakings given by the US would remove it and no violation of Article 23.2(c) could be found. We note, in particular, that under the SAA the USTR is obligated to do the following:

> if the matter cannot be resolved during that period [the reasonable period of time], seek authority from the DSB to retaliate.[723]

7.184 As a result, after evaluation of all elements relevant to Section 305, we come to the conclusion that the USTR under US law is precluded from exercising his or her discretion under Section 305 in a way that results in implementation of action before DSB authorization has been obtained. We note that USTR discretion in this respect has been lawfully curtailed. Section 305 (a)(2)(ii), in particular, allows the USTR to delay action when "necessary or desirable to obtain United States rights", in this case, the right to be obtained from the DSB to suspend concessions or other obligations. . . .

F. THE EC CLAIMS UNDER GATT 1994

7.186 The EC submits, finally, that in disputes involving goods, Section 306 requires the USTR "unilaterally" to impose measures as a consequence of a "unilaterally" determined failure to implement DSB recommendations, not authorized under the DSU, that necessarily violate Article I, II, III, VIII or XI of GATT 1994. Therefore, the EC concludes, also Section 306 itself violates the said GATT provisions.

7.187 We note, first, that these GATT claims depend on acceptance of the EC claims under the DSU. If action is explicitly allowed under the DSU, it can arguably not be prohibited under the more general GATT 1994. Since we have found that Section 306 is not inconsistent with Article 23 of the DSU, we can presume also that the dependent claim under GATT should be rejected.

7.188 Moreover, on the substance of its argument, the EC did not further develop this claim.[729] It did not even refer to the text of the GATT provisions invoked.

7.189 On these grounds, we find that the EC has not met its burden of proving that Section 306 as such constitutes a violation of GATT 1994.

NOTES AND QUESTIONS

1. In January 2000, the Dispute Settlement Body adopted the panel report on *United States–Sections 301-310 of the Trade Act of 1974*. WT/DS152/14 (Feb. 28, 2000), 2000

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723. We agree with the US that if the maximum delay were imposed, the total of 240 days subsequent to the lapse of the reasonable period of time–the original 60 day time-frame combined with the 180 days delay–should be sufficient for the USTR to await in all cases the completion of both Article 21.5 and Article 22.6 procedures as well as DSB authorization to suspend concessions.

729. In its rebuttal submission . . . the EC only stated the following on this claim: "Given that Sections 304(a)(2)(A) and 306(b), as amended, require the United States to resort to retaliatory trade action within certain time limits irrespective of the result of WTO dispute settlement procedures, the actions taken in the area of trade in goods and not authorised pursuant to Article 3.7 and 22 of the DSU will necessarily be in violation of US obligations under one or more of the following GATT obligations: the Most-Favoured-Nation clause (Article I GATT 1994), the tariff bindings undertaken by the United States (Article II GATT 1994), the National Treatment clause (Article III GATT 1994), the obligation not to collect excessive charges (Article VIII GATT 1994) and the prohibition of quantitative restrictions (Article XI GATT 1994)". . . .

WL 223528 (W.T.O.).

2. The EU argued (*see, e.g.*, paragraphs 7.4, 7.186 of the panel report) that §§ 301-310 require unilateral action by the USTR in breach of DSU article 23, and *as a result* this breach involved a breach of GATT articles I, II, III, VIII and XI. What is the connection between the two claimed breaches? Is the U.S. counterargument (*e.g.*, paragraph 7.9 of the report) responsive? Is it convincing? How convincing is the panel's response to this issue (*see* paragraphs 187-189)?

3. The EU also argued (*see, e.g.*, paragraphs 7.6-7.7 of the report) that §§ 301-310 were inconsistent with article XVI.4 of the WTO Agreement. In what sense were the provisions claimed to be inconsistent with article XVI.4?

4. How does the panel's view of its mandate in this dispute (*see, e.g.*, paragraphs 1.5, 7.11-7.13 of the report) affect its assessment of the arguments of the parties? Does the panel's mandate seem unduly artificial or abstract? (*Cf.* paragraphs 7.43, 7.53-7.54 of the report.) Why did the EU raise these claims outside the context of specific disputes over particular actions taken by the USTR under §§ 301-310? To what extent, then, are specific disputes involving §§ 301-310 at all relevant to the panel's deliberations (*see* paragraphs 7.127-7.130, 7.168)?

5. Review the panel's discussion in paragraphs 7.14-7.20 of burden of proof. How do the panel's views compare with those of the Appellate Body in *Canada–Measures Affecting the Importation of Milk, supra* at ▬? With those of the Appellate Body in *United States–Tax Treatment For "Foreign Sales Corporations", supra* at ▬?

6. How does the panel approach treaty interpretation (*see, e.g.*, paragraphs 7.21-7.22, 7.59-7.94 of the report)? In your experience, how does this approach compare with the way in which domestic courts approach the task of interpreting domestic legislation? How does it compare to the panel's approach to interpretation of domestic legislation (paragraphs 7.31-7.32 of the report)?

7. Compare the arguments of the EU and the United States on the legality of § 304 (paragraphs 7.29-7.30). Is the panel's response (paragraphs 7.31-7.131) convincing?

8. Would the hypothetical legislation described in note 658 of the panel report violate the GATT or the DSU? *Cf.* paragraphs 7.81-7.83 (offering similar hypothetical with respect to GATT art. III).

9. Compare the arguments of the EU and the United States on the legality of § 306 under DSU article 23.2(a) (paragraphs 7.138-7.140). Is the panel's response (paragraphs 7.142-7.168) convincing?

10. Consider the arguments of the EU on the legality of §§ 305-306 under DSU article 23.2(c) (paragraphs 7.171-7.172). Is the panel's response (paragraphs 7.174-7.184) convincing?

11. In its report, does the panel rely on "precedents" and "holdings"? What kind of authorities and what kind of reasoning does it employ in this report? To what extent, if at all, does the panel seem to consider itself "bound" by anything other than the texts of the international agreements that it is interpreting and applying? In this context, what does the panel mean, in note 675, when it refers to the "reversing of earlier GATT and WTO jurisprudence"?

D. CONTEMPORARY PRACTICE–NAFTA

The North American Free Trade Agreement (NAFTA)[1] provides the three signing parties–the United States, Canada and Mexico–with various procedures for resolving disputes.[2] NAFTA chapter 20 provides the generally applicable dispute settlement procedures, allowing parties to resolve disputes concerning the application and interpretation of NAFTA. This is a three-step process: (*i*) Parties are first required to consult with each other over such a dispute.[3] (*ii*) If the consultations fail to resolve the dispute, then the complaining party may seek conciliation or mediation through the NAFTA Free Trade Commission.[4] (*iii*) The complaining party may request an arbitral panel to resolve the dispute.[5] Each panel is composed of five members.[6] If there are *two* disputing parties, each party selects two panelists who are citizens of the other party, and both parties agree to the chair of the panel.[7] The panels are required to provide an initial report, findings of fact, a determination of the legal issues, and recommendations for resolution of the issues in dispute.[8] The final report of the panel is due within thirty days of the initial report.[9]

The following excerpt illustrates the NAFTA dispute settlement process under Chapter 20. Some background information will put the dispute in context. NAFTA provides for national treatment[10] and most favored-nation treatment[11] for transborder services, like trucking. Similar obligations apply to transborder investment.[12] At the inception of NAFTA, the United States had a longstanding ban on trucking services provided by Mexican-owned trucking firms,[13] as well as a ban on Mexican investment in U.S. trucking firms. In entering into the NAFTA, the United States made a reservation for the ban on Mexican transborder trucking services and investment, under Annex I of NAFTA, but the reservation expired on December 17, 1995. The following day, however, the U.S. Transportation Secretary publicly stated that the United States would not lift the ban, although the administration had the authority under U.S. legislation to do so in its discretion.[14] (In late 1982, the President had exercised his statutory discretion to remove the ban with respect to Canadian trucking firms.[15])

Mexico immediately requested consultations with the Office of the USTR. On January 19, 1996, consultations were held between the United States and Mexico, but the dispute remained unresolved. On January 24, 1998, Mexico requested a meeting with

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1. North American Free Trade Agreement, Dec. 17, 1993, *reprinted in* 32 Int'l Legal Mat. 296 (1994).

2. NAFTA Chapter 11 covers investment disputes; Chapter 19 covers antidumping and countervailing duty disputes, and Chapter 20 sets forth procedures for the majority of other disputes that may arise under NAFTA. The relevant provisions of NAFTA are reproduced in the Documents Supplement.

3. NAFTA, art. 2006.

4. *Id*. art. 2007, ¶ 1.

5. *Id*. art. 2011

6. *Id*. art. 2011, ¶ 1.

7. *Id*.

8. *Id*. art. 2016. Parties may submit written comments to the initial report within fourteen days. *Id*. art. 2016, ¶ 4.

9. *Id*. art. 2017, ¶ 1.

10. *Id*. art. 1202, ¶ 1.

11. *Id*. art. 1203.

12. *Id*. arts. 1102, ¶ 1, 1103, ¶ 1.

13. Bus Regulatory Reform Act of 1982 § 6, 49 U.S.C. § 10922(m) (1994).

14. *See* Robert S. Greenberger, *Clinton Delays Giving Mexican Trucks Freer Travel in the U.S. Border States*, Wall St. J., Feb. 5, 1996, at A10 (noting decision to continue ban).

15. Memorandum of the President, Determination Under the Bus Regulatory Reform Act of 1982, Sept. 20, 1982, 47 Fed. Reg. 41,721 (1982). While overtly political, the decision to differentiate in the treatment of Canadian and Mexican trucking firms also had been consistently justified by the United States on competitiveness grounds, since U.S. trucking firms were alomst completely excluded from the Mexican market. Interstate Commerce Commission Notice of Policy Statement, Passenger Operations by Mexican Motor Carriers-Implementation of the North American Free Trade Agreement, 59 Fed. Reg. 1406 (1994).

the NAFTA Free Trade Commission. The meeting took place on August 19, 1998, but was unsuccessful in resolving the dispute. A month later, Mexico requested formation of an arbitral panel to hear the dispute. The panel issued its initial report on November 29, 2000.

IN RE CROSS-BORDER TRUCKING SERVICES (UNITED STATES V. MEXICO)

USA-MEX-98-2008-01 (NAFTA Arbitral Panel, Feb. 6, 2001),

I. Introduction

A. The Dispute

1. The Panel in this proceeding must decide whether the United States is in breach of Articles 1202 (national treatment for cross-border services) and/or 1203 (most-favored-nation treatment for cross-border services) of NAFTA by failing to lift its moratorium on the processing of applications by Mexican-owned trucking firms for authority to operate in the U.S. border states. Similarly, the Panel must decide whether the United States breached Articles 1102 (national treatment) and/or 1103 (most-favored-nation treatment) by refusing to permit Mexican investment in companies in the United States that provide transportation of international cargo. Given the expiration on December 17, 1995 of the Annex I reservation that the United States took to allowing cross-border trucking services and investment, the maintenance of the moratorium must be justified either under the language of Articles 1202 or 1203, or by some other provision of NAFTA, such as those found in Chapter Nine (standards) or by Article 2101 (general exceptions).[2] . . .

11. Canada, which exercised its right to participate in accordance with Article 2013, insists that the major issue in interpreting Article 1202 is a comparison between a foreign service provider providing services cross-border (here, from Mexico into the United States), and a service provider providing services domestically. Canada also contends that a "blanket" refusal by the United States to permit Mexican carriers to obtain operating authority to provide cross-border trucking services would necessarily be less favorable than the treatment accorded to United States' truck services in like circumstances. . . .

III. FACTUAL BACKGROUND

. . .

44. Although the moratorium continued in place with regard to Mexico, there were some exceptions allowed in order to facilitate cross-border trade. Several categories of exceptions allowed Mexican carriers to continue entering into the United States: the commercial zone of border towns exception, the Mexico-Canada transit exception, the "grand-fathered" Mexican operators exception, and the US-owned Mexican truck exception. Another exception, that of Mexican carriers who lease both trucks and drivers to U.S. carriers for their use, was allowed until January 1, 2000. Mexican owned

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2. The Panel also notes that similar questions have been raised concerning Mexico's obligations under Annex I and Articles 1202 and 1203, in light of its alleged refusal to permit U.S. owned firms to obtain authority to operate in the Mexican border states, but that specific matter is not before this Panel. *See* paras. 22 and 24, *infra*.

and domiciled motor carriers that transport passengers in international charter or tour bus operations are also subject to an exception that began in 1994. . . .

46. As the regulations state, "U.S. motor carriers that operate exclusively within a commercial zone are not subject to the licensing jurisdiction of the Department of Transportation."[37]

48. Mexican carriers are allowed to enter the commercial zones, provided they have obtained a Certificate of Registration from the Federal Motor Carrier Safety Administration.[40] "The application process for Mexican motor carriers operating in border commercial zones is less extensive than the process by which carriers obtain authority to operate in the rest of the United States."[41] . . .

51. U.S. safety regulations apply to Mexican carriers operating in the border zones, but FMCSA [the Federal Motor Carrier Safety Administration] does not apply its on-site compliance review requirements to carriers based in Mexico.

52. Thus, all carriers are fully subject to all U.S. safety regulations. They must also have trip insurance, carry evidence of the insurance of their trucks, and have U.S. registered agents.[43]

53. It appears from the submissions of both the United States and Mexico that the vast majority of the Mexican trucks entering the border zones are used solely for drayage services, i.e a Mexican tractor pulls a trailer from the Mexican side of the border into the U.S. border zone. The trailer is then transferred to a U.S. tractor, which transports the trailer to its final U.S. destination. In the current proceedings, the United States claims that most of the trailers are U.S.-owned, but there is also a significant trans-shipment of goods between trailers owned by different carriers. . . .

55. In 1999, 8,400 Mexican firms had authority to operate in the commercial zones.

56. The second exception relates to Mexican operators that transit through the United States to Canada. Under the provisions of 49 U.S.C. § 13501, the Department of Transportation's jurisdiction is limited to requiring operating authorization from carriers operating between states of the United States or between a state of the United States and a foreign country. Congress has not granted the Department of Transportation the authority to require trucks transiting from Mexico to Canada to seek operating authority.

57. Mexican trucks crossing the United States in transit to Canada are unaffected by the moratorium. Therefore, the Mexican trucks are allowed to enter the United States in transit to Canada and do not require any operating authorization to do so. The only formal requirements to be complied with by Mexican trucks consist of insurance and compliance with the U.S. safety regulations.

58. The United States claimed that a report on Mexican domiciled motor carriers prepared by the USDOT [U.S. Department of Transportation], Office of Inspector General, in 1999, indicated that only one Mexican trucking firm was then engaged in

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37. 49 C.F.R. §372.241. . . .

40. As of January 1, 2000, jurisdiction over most motor carrier regulation, which was the responsibility of the Federal Highway Administration, became the responsibility of the newly-created FMCSA.

41. . . . *See* 49 C.F.R. Part 368. . . .

43. . . . The Parties agree to the fact that trip insurance is required, but differ as to why trip insurance is required instead of continuous insurance. The United States denied that the use of trip insurance instead of continuous insurance "demonstrates that the United States has little interest in the safety of Mexican trucks operating in the commercial zones." Rather, "[a]n insurer's potential liability arising from trip insurance is just the same as that arising from continuous insurance, and in both cases the insurer has the same incentives to reduce its potential liability." . . . Mexico does not assert that the United States is unconcerned about safety compliance, but rather that the United States is satisfied with the safety of Mexican carriers and trailers. . . .

transit operations between Mexico and Canada through the United States.

59. "Grandfathered" Mexican trucking companies that had acquired operating authority prior to 1982, when the moratorium came into effect, are not affected. A total of five Mexican carriers are entitled to these exemptions.

60. The ICC Termination Act of 1995 exempts from the operation of the moratorium US-owned Mexican-domiciled truck companies.

61. U.S.-owned, Mexican-domiciled carriers total approximately 160. Their equipment must be either U.S. made or imported, duty paid. These carriers are either commercial, for-hire carriers transporting certain commodities, generally food or raw materials, or private, not-for-hire carriers transporting their own goods.

62. Prior to the enactment of the Motor Carrier Safety Improvement Act of 1999, Mexican carriers were able to lease out their equipment and drivers to U.S. trucking companies. The provision was intended to allow U.S. carriers to augment their fleets without making capital investments in new equipment. However, it was realized that "this provision could be used to, in essence, sell U.S. carrier's operating authority to a Mexican carrier for operations beyond the commercial zone." Section 219 of the Motor Carrier Safety Improvement Act of 1999 ended the leasing exception.[54]

63. A change in the restrictions imposed on Mexican motor carriers occurred in 1994 when pursuant to an agreement between the U.S. and Mexico to provide reciprocal treatment for charter and tour bus operators, a Presidential Memorandum of January 1, 1994, was issued. This Memorandum authorized the Interstate Commerce Commission to issue operating authorities to Mexican-owned or -controlled passenger carriers for international routes between Mexico and the United States and not for travel solely between U.S. destinations. This position was preserved by Annex 1 of NAFTA, and Mexican tour operators thus continue to be allowed to provide cross-boundary services in the United States. . . .

66. NAFTA came into force on January 1, 1994. Under Annex I of NAFTA, the Parties are obliged to phase-out certain reservations to Articles 1102 or 1202 (national treatment) and Articles 1103 or 1203 (most-favored-nation treatment).[57]

67. With respect to cross-border trucking service, Annex I provides that a Mexican national will be permitted to obtain operating authority to provide cross-boundary trucking services in border states three years *after the signing* of NAFTA, *i.e.*, December 18, 1995, and cross-border trucking services throughout the United States six years after the date of *entry into force* of NAFTA, *i.e.*, January 1, 2000.

68. With respect to investment, the phase-out deadline for the reservation was three years *after the signing* of NAFTA, *i.e.*, December 18, 1995, for the establishment of enterprises providing trucking services for the transport of international cargo between points within the United States; and seven years *after the date of entry into force* of NAFTA, *i.e.*, January 1, 2001, for the establishment of enterprises providing bus services between points in the United States. . . .

77. On December 4, 1995, U.S. Secretary of Transportation Peña stated at a joint U.S.-Mexico press conference that both the United States and Mexico were "ready for December 18." Then on December 18, 1995, Secretary Peña issued a press release

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54. The Parties disagree as to whether section 219 was instigated because of safety (U.S. contention) or to protect domestic carriers from competition (Mexican contention). The facts, however, are not in dispute. . . .

57. Annex I set out each Parties' reservations with respect to existing measures from the obligations imposed by Articles 1102 and 1202 and 1103 and 1203. It also set out commitments for immediate or future liberalization. The Annex I commitments oblige each party to liberalize specific sectors by dates set in the "phase-out" section of each reservation. . . .

which stated that although Mexico and the United States were working to improve Mexican truck safety, because it was not yet a completed process, the United States would accept and process applications from Mexican trucking firms, but the applications would not be finalized. Therefore, no Mexican trucks have been allowed to pass out of the pre-existing commercial zones until the United States concludes consultations with the Mexican government. Through this refusal to finalize Mexican applications, the United States essentially continued the moratorium on Mexican trucks that had been in place prior to December 18, 1995.

78. The United States explained its actions were based on the alleged lack of safety in Mexican trucks, and referred to two alleged incidents involving Mexican trucks, one in November 1995 and the other in Fall 1995, where spillages of hazardous material had occurred. In the latter alleged incident, the driver of the Mexican truck was 16 years old, carried no insurance or shipping papers and the truck involved had faulty brakes and a number of bald tires. Mexico contends that these alleged incidents are not relevant to this dispute, because Mexico could have presented information on several incidents in which U.S. truck operators caused accidents while acting in breach of U.S. law.

79. As well, in early December 1995, the GAO [the General Accounting Office], the "investigative arm" of the U.S. Congress, made available to the USDOT its report on Mexican cross-border trucking. The report was officially released on February 29, 1996. The report stated that there were significant differences between United States and Mexican truck safety regulations. It reported that a Mexican truck inspection and enforcement program had been established, but was lacking the facilities and personnel to initiate it. They also reported that a large percentage of Mexican trucks operating in the commercial zones of the four U.S. border states failed to meet U.S. truck safety standards.[69] . . .

82. On December 18, 1995, the date of implementation of NAFTA's cross-border truck service provisions, the United States Secretary of Transportation issued a second press release announcing, *inter alia*, that:

> Effective today, NAFTA parties will begin accepting applications from foreign motor carriers for the purpose of operating in international commerce in the Mexican and [United States] border states.[71]

However, the Transportation Secretary stated that the final disposition of pending applications will be held until consultations between the United States and Mexico to further improve their motor carrier safety and security regimes have been completed. To date, the moratorium is still in place.

83. The press release also announced that beginning December 18, 1995, Mexican citizens would be allowed to invest in U.S. carriers engaged in international commerce.

84. Despite its assertions that Mexican citizens would be allowed to invest in U.S. carriers as of December 1995, to date the USDOT maintains a complete ban on Mexican nationals owning or controlling U.S. cargo and passenger motor carrier service providers. This ban is enforced by the application form for *new* operating authority,

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69. . . . Although it is undisputed that the GAO report did provide this information on the Mexican regulatory system, Mexico contends that it is not relevant to the issue to be decided. Mexico contends that its domestic regulations do not have to be harmonized with the United States domestic regulations in order to permit individual Mexican carriers to cross into the U.S. border states.

71. U.S. Dept. of Transportation News, Remarks Prepared for Delivery: U.S. Secretary of Transportation Federico Peña NAFTA Border Opening Remarks (Dec. 18, 1995). . . .

which requires that the applicant certify that the applicant is not a Mexican national, and the carriers are not owned or controlled by Mexican nationals. To gain approval of an application to acquire an *existing* motor carrier, the USDOT also requires that the applicant indicate whether the party acquiring rights is either domiciled in Mexico or the carrier is owned or controlled by persons of that country. These restrictions essentially ban any Mexican investment in U.S. carriers, because the applications would not be approved if they indicated Mexican ownership.

85. These statements pertaining to Mexican entities being involved in transactions are required under 49 C.F.R. § 1182.2(a)(10). It appears that there are no published or other formal announcements of the Department of Transportation that implement this restriction other than the application form itself. However, the operating restrictions imposed formerly by the ICC and currently by the USDOT in effect prevent new grants of operating authority to U.S. carriers owned or controlled by Mexican carriers. . . .

88. The fact that differences exist in the two domestic regulatory systems is not in dispute. . . . Both Mexico and the United States agree that the Mexican regulatory system is not identical to that of the United States. The disagreement is therefore whether the differences in the domestic regulatory systems justify the ban of the United States of Mexican trucks entering the territory. . . .

95. The United States explained that several of its key truck safety regulations and requirements are not incorporated in the Mexican carrier safety regulations. There is no regulation of driver hours of service, and apart from motor carriers carrying hazardous materials no requirement to maintain a driver logbook. There are no specific Mexican regulations governing the condition and maintenance of commercial truck safety equipment. Again, with the exception of vehicles transporting hazardous materials, Mexican trucks are not required to undergo periodical inspections.

96. In respect to hazardous materials, the United States stated that the Mexican regulations follow closely the United Nations Recommendations for the Transport of Dangerous Goods but nevertheless significant gaps remained.

97. The United States and Mexico therefore agree that there are substantial differences between the United States and Canadian regulatory systems and the Mexican regulatory system. . . .

IV. Contentions of the Parties and Canada

. . .

A. Mexico's Contentions

. . .

103. Mexico asserts that Mexico's burden under Rule 33 of the Model Rules of Procedure for Chapter Twenty–of establishing that the United States measure is inconsistent with provisions of the Agreement–is met by a showing that "the U.S. Government has refused to process applications for Mexican motor carriers without proper justification."

104. Mexico argues that the United States, under Rule 34 of the Model Rules, given that it is asserting the applicability of an exception under NAFTA, has the burden of establishing that the exception applies.

105. Mexico asserts that this Panel must interpret NAFTA in accordance with the requirements of Article 102(2), which provides that "The Parties shall interpret and apply the provisions of this Agreement in the light of its objectives set out in paragraph 1 and in accordance with applicable rules of international law." This means, in essence, the Article 102(1) objectives of eliminating "barriers to trade in, and facilitate the cross-

border movement of goods and services between the territories of the Parties; promote conditions of fair competition in the free trade area; and increase substantially investment opportunities in the territories of the Parties, among others."

106. Mexico cites with approval *Tariffs Applied by Canada to Certain United States Origin Agricultural Products* (CDA-95-2008-01), which states, *inter alia*, that "Any interpretation adopted by the Panel must, therefore, promote rather than inhibit NAFTA's objectives."[82]

107. Mexico also notes the applicability of the Vienna Convention on the Law of Treaties, in particular the Article 31 requirement that "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 light of its object and purpose." This is the "starting point of an interpretation of NAFTA." Mexico further urges that the Panel observe the "principle of effectiveness" in which any "interpretation must give meaning and effect to all the terms of the treaty."

108. Under Article 105 of NAFTA, "The Parties shall ensure that all necessary measures are taken in order to give effect to the provisions of this Agreement." Although the United States claims that it has not yet made all the necessary preparations for opening the border, which is contradicted by Transportation Secretary Peña's remarks delivered on December 4, 1995, Mexico asserts that failure to prepare is not an excuse. "Otherwise, the Parties would be free to circumvent virtually any provision of NAFTA on that basis, contrary to the principle of effectiveness."

109. Mexico asserts that no NAFTA provision entitles a party to impose its own laws and regulations on the other. This would be an unacceptable interference in the sovereignty of another state, and certainly not something to which any party to NAFTA has committed. Therefore, Mexico is under no obligation under NAFTA to enforce U.S. standards, despite cooperation between the United States and Mexico to make the regulatory systems compatible "from day one."

110. However, according to Mexico, the United States has made adoption of an identical system of motor carrier regulation a condition of NAFTA implementation, even though NAFTA contemplates that harmonization would not be a condition. . . .

117. Mexico believes that the U.S. "flagging" action, which determines "that Mexican motor carriers, as a class, are too dangerous to allow in the United States" is not only factually incorrect, but the "flagging" action is a denial of national treatment. U.S. carriers, unlike Mexican carriers, "are entitled under U.S. law to both (i) consideration on their individual merits and (ii) a full opportunity to contest the denial of operating authority. Both of these rights have been denied to Mexican carriers in violation of the NAFTA." . . .

120. In discussing the phrase "in like circumstances," Mexico indicates its disagreement with the United States over the scope of the term. According to Mexico, the U.S. Counter-Submission suggests that the term "in like circumstances" somehow should be interpreted as creating a blanket exemption from the obligation of national treatment when a Party asserts it is protecting health and safety. Mexico believes, however, that the negotiating history of NAFTA does not support this interpretation.

121. Mexican carriers are seeking to provide long-haul truck service–the exact same type of service provided by U.S. and Canadian carriers. Especially given the negotiating

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82. . . . *In the Matter of Tariffs Applied by Canada to Certain United States Origin Agricultural Products*, CDA 95-2008-01, Final Panel, para. 122 (Dec. 2, 1996).

history of NAFTA, which shows that the Parties agreed that the term "service providers . . . in like circumstances" was intended to have the same meaning as "like services and service providers," there can be no question that individual Mexican carriers are "in like circumstances" with U.S. and Canadian carriers.

122. According to Mexico, the source of the "in like circumstances" language was the United States-Canada Free Trade Agreement ("FTA"), Article 1402.[a] This language, according to Mexico, "did not authorize a Party to withhold national treatment on the grounds of protecting health and safety." Rather, "the term 'in like circumstances' was intended to serve a function analogous to the role of the term 'like product' in matters involving trade in goods– that is, to ensure that comparisons are made of the regulation of reasonably similar services and companies."

123. If the fact that Mexican carriers are domiciled in Mexico required some adjustments in the application process or the oversight system, Mexico believes that the United States could have made those adjustments. "In other words, even if Mexican carriers were somehow not exactly 'like' U.S. and Canadian carriers, it was within the power of the United States to impose requirements that would make them 'like.' The United States did not adopt any such requirements, but instead arbitrarily refused to allow Mexican carriers from doing business in the United States (and even then, only in circumstances where they might compete directly with U.S. carriers)."

124. Mexico supports this interpretation by noting that if the simple fact that a service provider is from a particular country was sufficient to constitute "unlike circumstances" with domestic companies, NAFTA national treatment obligation would have no meaning.

125. Mexico further argues that national and most-favored-nation ("MFN") treatment may not be made conditional "on adoption by another Party of laws and regulations that the first Party deems desirable." The United States, in this respect, has failed to demonstrate "why Mexican regulation of service providers in Mexico–the vast majority of whom will never enter the United States–should be considered relevant to its treatment of the small number of Mexican carriers seeking authorization to provide service within U.S. territory." Nor has the United States offered any explanation as to how these NAFTA obligations could be considered "conditional on the adoption of identical or equivalent regulatory systems." . . .

131. Mexico believes that the United States cannot use Article 2101 as justification for its inaction. With regard to the general exceptions, Mexico observes that Article 2101(2) provides in pertinent part:

> Provided that such measures are not applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on trade between the Parties, nothing in . . . Chapter Twelve (Cross-Border Trade in Services) . . . shall be construed to prevent the adoption or enforcement by a Party of measures necessary to secure compliance with laws or regulations that are not inconsistent with the provisions of this Agreement, including those relating to health and safety and consumer protection.

132. Mexico notes that Article 2101(2) permits NAFTA-inconsistent measures only "if the laws or regulations with which compliance is being secured are themselves *not* inconsistent with the Agreement."

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a. The text of FTA art. 1402 is quoted by the panel in paragraph 250, *infra*.

133. Mexico also asserts that the scope of Article 2101(2) should be interpreted in light of long-standing GATT (General Agreement on Tariffs and Trade) practice, analogous to the GATT Article XX(d) general exceptions. In addition to the requirement that the "laws or regulations" not be inconsistent with the agreement, the measures must be "necessary to secure compliance" and not be applied in a manner that would result in unjustifiable discrimination or a disguised restriction on international trade.[113]

134. Article 2101(2) could not be relevant unless the Party generally allows the cross-border service, but seeks to adopt or enforce other measures that may be inconsistent with NAFTA, in order to secure compliance with the principal law or regulation. In other words, Article 2101(2) only covers measures designed to prevent actions that would be illegal under the principal law or regulation. The refusal to process applications by Mexican persons cannot be justified under Article 2101 because the U.S. government is not acting to secure compliance with any law or regulation. In addition, the U.S. measure is an arbitrary and unjustifiable discrimination against persons from Mexico and a disguised restriction on trade. . . .

136. Mexico further asserts that NAFTA language "provided that such [exceptional] measures are not applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on trade between the Parties" and are "necessary to secure compliance with laws or regulations that are not inconsistent with the provisions of this Agreement" is indicative of the Parties' intent "that NAFTA Article 2101(2) be interpreted in the same manner as GATT Article XX(d)." Under these circumstances, "GATT and WTO jurisprudence on the interpretation of GATT Article XX(d) should be considered highly probative of the meaning of NAFTA Article 2101(2) including *Canada – Certain Measures Concerning Periodicals*,[117] *U.S.–Standards for Reformulated and Conventional Gasoline*[118] and *U.S. – Import Prohibition on Certain Shrimp and Shrimp Products.*"[119]

137. Mexico notes that the United States invoked the "necessary" language in *Reformulated Gasoline* and *United States - Section 337 of the Tariff Act of 1930* in contesting Canada in *Periodicals*, although the Panel in *Periodicals* did not reach the issue in its decision. After reviewing the Panel and Appellate Body decisions in *Reformulated Gasoline*, Mexico notes:

> [thus, the Appellate Body] held that the requirement that a Party adopt measures reasonably available to it that were the least inconsistent with the GATT derived from the obligation in the introductory clause to Article XX that GATT-inconsistent measures not constitute unjustifiable discrimination or a disguised restriction on trade. It also found that the failure of a government to adequately pursue the possibility of inter-governmental cooperative arrangements for enforcement was conclusive evidence that the government had not adopted measures reasonably available to it that were the least inconsistent with the GATT.

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113. . . . *United States - Section 337 of the Tariff Act of 1930*, [GATT] Panel Report adopted Nov. 7, 1989, BISD/34S [hereinafter *Section 337*].

117. *Canada – Certain Measures Concerning Periodicals*, [WTO] Panel Report adopted Mar. 14, 1957, WT/DS31/R [hereinafter *Periodicals*].

118. *United States - Standards for Reformulated and Conventional Gasoline*, WTO Appellate Body (WT/DS/9, May 20, 1996) [hereinafter *Reformulated Gasoline*].

119. . . . *US-Import Prohibition of Certain Shrimp and Shrimp Products,* WTO Appellate Body (WT/DS58/AB/R, Oct. 12, 1998) [hereinafter *Shrimp*].

138. Finally, citing *Shrimp*, Mexico notes that the Appellate Body "held that the 'rigidity and inflexibility' of the U.S. measure, in requiring that foreign countries adopt a regulatory program 'essentially the same' as that of the United States, constituted arbitrary discrimination within the meaning of Article XX's introductory clause."

139. In terms of the instant case, Mexico argues that *Reformulated Gasoline* and *Periodicals* demonstrate that the U.S. moratorium must *secure compliance* with another law or regulation that is NAFTA-consistent; the moratorium must be *necessary* to secure compliance; and the moratorium must not be applied in a manner that would constitute a means of *arbitrary or unjustifiable discrimination* between countries where the same conditions prevail or *a disguised restriction on trade*.

140. According to Mexico, the U.S. moratorium does not meet these criteria. . . .

143. Mexico does not believe that the Panel should "reach the issue of whether the United States has committed a non-violation nullification or impairment of benefits Mexico reasonably expected to accrue from NAFTA, because Mexico has already identified several direct violations." Should the Panel nevertheless do so, "Mexico believes that aspects of the *Procurement* case decision are useful in evaluating how the pertinent terms of NAFTA should be interpreted in this case." *Korea - Measures Affecting Government Procurement* is relevant because it confirms the application of the principle of *pacta sunt servanda* in Article 26 of the Vienna Convention on the Law of Treaties[b] to "the interpretation of the WTO agreements and to the process of treaty formation under the WTO." Notably, *Procurement*, "by highlighting the requirement of good faith performance of treaties, helps to illustrate a fundamental problem with the U.S. position in this dispute." Mexico believes that the United States regrets that it made concessions on cross-border truck service. . . .

147. Mexico notes that "the United States expressly acknowledged that the ban on Mexican investment was not based on concerns about safety" but, rather, quoting the U.S. agent, "arose from the moratorium, it's part of the moratorium that is still in place." Thus, although the United States argued in its written submissions that Mexico must identify a specific Mexican national who is interested in investing, at the hearing it stated that even if Mexico could identify a potential investor, this would not be sufficient for the United States to concede a NAFTA violation. The United States declined to provide an explanation for this position. Under these circumstances, Mexico submits that the U.S. violation of Articles 1102 and 1103 has been clearly established.

148.Mexico notes that U.S. law continues to require an applicant for new motor carrier authority in the United States to certify that it is not a Mexican national or controlled by Mexican nationals, submitting a statement to that effect. The same applies to transfers of existing operating authority. "Under these circumstances, it would be unreasonable to expect that Mexican carriers would attempt to seek approval to establish a U.S. carrier or to acquire an existing U.S. carrier." Mexico asserts that under well-established GATT and WTO principles,

> where a measure is inconsistent with a Party's obligations, it is unnecessary to demonstrate that the measure has had an impact on trade. . . . Where there have been direct violations of NAFTA, as in this case, there is no requirement for the Panel to make a finding that benefits have been nullified or impaired; it is sufficient to find that the U.S. measures are

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b. The customary public international legal principle *pacta sunt servanda*–that treaty obligations must be fulfilled in good faith by a state party to a treaty–is codified in the Vienna Convention on the Law of Treaties, 1155 U.N.T.S. 331. Vienna Convention, art. 26 states: "Every treaty in force is binding upon the parties to it and must be performed by them in good faith."

inconsistent with NAFTA.

149. One of Mexico's core arguments is that, notwithstanding U.S. assertions that postponement of implementation of the truck services provisions was based on safety concerns, the real U.S. motivation was political considerations rather than safety. In support of this contention, Mexico cites pre-December 18, 1995 statements by Transportation Secretary Peña and various state government officials as to U.S. readiness for implementation. Mexico also cites, with disapproval, press accounts of Teamsters' Union influence on the U.S. Government decision to postpone implementation initially, and on political considerations that have led to further postponements. . . .

151. Mexico argues that the U.S. ban on issuing operating authority to additional Mexican carriers to provide long-haul service within the United States is not a safety measure, but rather an "economic embargo."[c] . . .

B. The United States' Contentions

153. According to the United States:

> [t]he Mexican safety regime lacks core components, such as comprehensive truck equipment standards and fully functioning roadside inspection or on-site review systems. In light of these important differences in circumstances, and given the experience to-date [*sic*] with the safety compliance record of Mexican trucks operating in the U.S. border zone, the United States decision to delay processing Mexican carriers' applications for operating authority until further progress is made on cooperative safety efforts is both prudent and consistent with U.S. obligations under the NAFTA.

154. Thus, the United States is not obligated to grant Mexican trucking firms operating authority when there are not yet adequate regulatory measures in place in Mexico to ensure U.S. highway safety. The United States asserts "that NAFTA contains no such requirement. To the contrary, under NAFTA's national treatment and most-favored-nation obligations, a NAFTA Party may treat service providers differently in order to address a legitimate regulatory objective."

155. According to the United States, Mexican carrier safety cannot be assured on a case by case basis: "A carrier-by-carrier approach, however, cannot effectively ensure safety compliance by Mexican motor carriers operating in the United States. Rather, as the United States has explained, highway safety can only be assured through a comprehensive, integrated safety regime. It is for this reason that the United States is working with Mexican officials to develop comparable motor carrier safety systems." Nor can the United States, as a practical matter, inspect every truck as it crosses the border.

156. The United States notes the deficiencies of the Mexican oversight system:

> The Government of Mexico cannot identify its carriers and drivers so that unsafe conduct can be properly assigned and reviewed. While we understand that the Government of Mexico is engaged in an extensive effort to register all of its motor carriers and place them

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c. Presumably, this characterization was meant only as a metaphor. On economic embargoes and other sanctions, see Chapter XIII, *infra* at ■■■.

> in a database that would facilitate the assignment of safety data, that database does not contain any safety data. Therefore, Mexico cannot track the safety fitness of its carriers and drivers. . . . Without such carrier safety performance history, the United States cannot conduct a meaningful safety fitness review of Mexican carriers at the application stage.

157. The United States also contends that it would be futile to try to perform inspections of Mexican carriers in Mexico because "Mexican carriers are not required to keep the types of records that are typically reviewed in these inspections." . . .

158. The United States also disagrees with Mexico's reliance on Article 105. According to the United States,"the intent of Article 105 is simply to clarify that each NAFTA Party is responsible for ensuring that its state and provincial governments are in compliance with NAFTA obligations." Moreover, "Nothing in Article 105 suggests that measures entailing cooperation between NAFTA Parties are somehow forbidden or excluded." . . .

160. According to the United States,"Adequate assurances of safety also require that Mexico, as Canada has done, adopt safety controls within its own borders. The United States has been engaged in extensive cooperative efforts with Mexico to assist in the development of the Mexican safety system. Although Mexico has made substantial progress, work remains undone." Under these factual circumstances, "NAFTA's national treatment and most-favored-nation obligations do not, as Mexico argues, require the United States to treat Mexican trucking firms in the same manner as U.S. and Canadian firms."

161. In particular, NAFTA does not obligate:

> the United States to license the operation of Mexican trucking firms in circumstances in which: (1) serious concerns persist regarding their overall safety record; (2) Mexico is still developing first-line regulatory and enforcement measures needed to address trucking safety standards; and (3) essential bilateral cooperative arrangements are not fully in place.

162. Moreover, the United States contends that under Rule 33 of the Chapter Twenty Rules of Procedure, the burden of proving violations of Article 1202 and 1203, is on Mexico, "including the burden of proving relevant regulatory circumstances and demonstrating that those circumstances are 'like'."

163. The United States suggests that:

> to prove that a particular measure adopted or maintained by another NAFTA Party is inconsistent with Articles 1202 and 1203, the complaining Party must demonstrate each of the material elements of those [a]rticles. Those include showing: 1) the existence of one or more measures adopted or maintained by a Party; 2) that the measure(s) relate to cross-border trade in services; 3) the treatment accorded by the measure(s); 4) the extent to which that treatment may favor domestic, or certain foreign, service providers over the providers of the complaining Party; 5) the relevant "circumstances" under which that treatment is accorded; and 6) whether those circumstances are "like".

164. Mexico is faulted for failing to address all of these elements:

> Most importantly, it has failed to describe the "circumstances" under which the United States is treating Mexican Firms for safety purposes. Moreover, Mexico has also neglected to demonstrate that those circumstances are "like" the circumstances that pertain to the regulation of U.S. and Canadian trucking companies.

165. The inclusion of the qualifying "like circumstances" language "permits NAFTA Parties to accord differential, and even less favorable, treatment where appropriate to meet legitimate regulatory objectives." The United States quotes with approval from Mexico's opening submission, "even if Mexican carriers were somehow not exactly 'like' U.S. and Canadian carriers, it was within the power of the United States to impose requirements that would make them 'like.'" However, the United States differs with Mexico on the fundamental issue of whether "Mexican carriers are 'like' U.S. and Canadian carriers for purposes of applying NAFTA's national treatment and MFN provisions."

166. The United States reviews the use of the term "like circumstances" in U.S. bilateral investment treaties, arguing that NAFTA language is derived from them, even though the BIT language is "in like situations." Here and in the FTA, national treatment does not mean that a particular measure must in every case accord exactly the same treatment to U.S. and Canadian Service providers. Under paragraph three of FTA Article 1402, covered service providers from the two countries may be treated differently to the extent necessary for prudential, fiduciary, health and safety, or consumer protection reasons, as long as the treatment is equivalent in effect to that accorded to domestic service providers and the party adopting the measure provides advance notice to the other in conformity with Article 1803.

167. According to the United States, NAFTA negotiating history confirms this earlier approach to the "in like circumstances" language, adopting "in like circumstances" on the understanding that it had similar meaning to "like services and services providers," as preferred originally by Canada and Mexico.

168. Further support for the U.S. position is found in the U.S. Statement of Administration Action, which provides in pertinent part that "Foreign service providers can be treated differently *if circumstances warrant. For example, a state may impose special requirements on Canadian and Mexican service providers if necessary to protect consumers to the same degree as they are protected in respect of local firms*." Similarly, the Canadian Statement of Implementation provides that " a Party may impose different legal requirements on other NAFTA service providers to ensure that domestic consumers are protected to the same degree as they are in respect of domestic firms." Thus, "the 'like circumstances' language of Articles 1202 and 1203 makes clear that the United States may make and apply legitimate regulatory distinctions for purposes of ensuring the safety of U.S. roadways."

169. The United States also contends that "The regulatory environment in which U.S., Canadian, and Mexican trucking firms operate is a critical 'circumstance' relevant to U.S. treatment of those firms because it helps to establish industry safety practices in the three countries. . . .

171. The United States observes that "[a]nother circumstance relevant to the treatment of U.S., Canadian, and Mexican trucking firms is the ability of U.S. transportation safety authorities to enforce U.S. safety regulations with respect to those carriers." While the "maintenance of government databases of accident and safety records, with respect to both firms and drivers, is an important element of safety regulation in the United States (and Canada) . . . the United States has no access to similar data for Mexican firms or drivers." Moreover, "U.S. highway safety regulators rely in part on their ability to conduct on-site audits and inspections of U.S. firms and, where appropriate, to impose civil or criminal penalties." However, "U.S. regulators have no right to conduct inspections or audits in Mexico, only limited and recent experience with Mexico on joint inspections (by contrast with a long track record with

Canada), and limited ability to impose and collect civil or criminal penalties with respect to Mexican firms that might ignore U.S. safety regulations." . . .

177. The United States explains certain carriers are permitted to "transit" U.S. territory from Mexico to Canada because

> the Congress has not granted the U.S. Department of Transportation ("DOT" or "Department") the authority to require such transit carriers to seek operating authority. Therefore, transit operations are unaffected by the moratorium on the issuance of operating authority to Mexican motor carriers for operations outside the commercial zone. All firms operating in the United States, however, regardless of whether they are subject to such registration requirements, are subject to DOT's safety jurisdiction.

U.S.-owned, Mexican-domiciled carriers and "grandfathered" carriers are unaffected by the statutory moratorium and thus are also permitted to transport goods from Mexico to the United States beyond the border zone.

178. However, the United States does not believe that the exemption of these groups from the moratorium "demonstrates that the United States does not have authentic safety concerns about Mexican carriers." "The number of carriers entitled to these exemptions represents only a small fraction–about two percent–of Mexican firms engaged in cross-border operations. Specifically, 8,400 Mexican firms have authority to operate in the commercial zones, while a total of only 168 Mexican carriers are entitled to the above-discussed exemptions." . . .

181. With regard to national treatment and most-favored-nation obligations, according to the United States,

> the relevant issue is whether the U.S. actions are consistent with its Chapter Twelve national treatment and MFN obligations in light of the different circumstances applicable to U.S. and Canadian trucking firms, on the one hand, and Mexican trucking firms on the other . . . it is acting reasonably and appropriately by delaying the processing of Mexican firms' applications for operating authority while U.S. and Mexican transportation officials work cooperatively to establish adequate safety enforcement tools to ensure that the grant of additional operating authority to Mexican firms does not undermine highway safety. Applying NAFTA's national treatment and MFN obligations to this set of facts turns on a close analysis of highway safety issues, not abstract arguments regarding "conditionality".

182. According to the United States, Mexico has failed to meet its burden of proof regarding denial of investment benefits, "because Mexico had not shown that any Mexican national meets the definition of 'investor' in Chapter Eleven." In this respect, the United States disagrees with Mexican reliance on WTO doctrines under which a complaining Party does not have to show trade impact. Moreover, the United States believes under WTO principles "complaining parties bear the burden of proving an alleged violation by a WTO Member of its WTO obligations." . . .

190. The United States also asserts that Mexico has made no case for nullification or impairment under NAFTA Annex 2004, noting some similarity to the *Korean Procurement* case in the WTO. According to the United States, Mexico has the burden of showing nullification or impairment and has made no such argument. Also, the United States declares that under NAFTA, a nullification or impairment claim may not be made if it

> would be subject to an Article 2101 exception. As the United States has shown, differential

> treatment for Mexican carriers is warranted by safety concerns, and is thus consistent with the U.S. obligations under the national treatment and MFN provisions of Chapter Twelve. For the very same reasons, (and in the event that the Panel had needed to examine this issue in response to a nullification or impairment claim), the U.S. measure would fall squarely within the scope of Article 2101(2).

191. The United States asserts that the "subjective" motivation for the alleged U.S. violations–as argued by Mexico–should not be the basis for the Panel's analysis. WTO Appellate Body decisions support the position of the United States that the pertinent issue here is whether safety concerns warrant the differential treatment provided to Mexican carriers, and not–as Mexico claims–the subjective motivations of U.S. decision-makers in December 1995.

192. The United States cites to *Japan - Alcoholic Beverages*,[205] where the Appellate Body determined that "This is not an issue of intent" and determined "an examination in any case of whether dissimilar taxation has been applied so as to afford protection requires a comprehensive and objective analysis of the structure and application of the measure in question on domestic as compared to imported products."[206]

193. Also, in *Chile - Alcoholic Beverages*,[207] the Appellate Body noted that

> The *subjective* intentions inhabiting the minds of individual legislators or regulators do not bear upon the inquiry, if only because they are not accessible to treaty interpreters. It does not follow, however, that the statutory purposes or objectives–that is, the purpose or objectives of a Member's legislature and government as a whole–to the extent that they are given *objective* expression in the statute itself, are not pertinent.

194. Consequently, the Panel in this case should "likewise examine U.S. compliance with national treatment obligations based on a fact-specific analysis of the U.S. measure and all of the relevant circumstances, and not–as the Appellate Body wrote–on the 'subjective intentions inhabiting the minds of individual . . . regulators.'"

C. Canada's Contentions

195. Canada, exercising its right to participate in the Panel proceeding under Article 2013, avoids comment on the specific facts of the case.

196. Canada contends that the key issue in interpreting the requirements of Article 1202 (national treatment for cross-border services) is "a comparison between a service provider providing services cross-border, and a service provider providing services locally." Under those circumstances, Canada submits:

> A blanket refusal to permit a person of Mexico to obtain operating authority to provide cross-border truck services . . . would, on its face, be less favorable than the treatment accorded to United States truck service providers in like circumstances.

Canada takes a similar position with respect to Article 1102 (national treatment for investment).

197. Canada also challenges the U.S. refusal to allow Mexican investors to invest in

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205. *Japan - Taxes on Alcoholic Beverages*, Panel Report adopted Oct. 4, 1996, WT/DS8/AB/R.
206. *Id.* at 28-29. . . .
207. *Chile- Taxes on Alcoholic Beverages*, Panel Report adopted Dec. 13, 1999, WT/DS87/AB/R.

the U.S. trucking market. Canada contends that under Article 1102:

> Unless there is a difference in circumstances between a Mexican investor seeking a license in the United States and a United States investor seeking a similar license, the Mexican investor is entitled to like treatment. [Therefore, m]aintaining a regulation that requires the licensing authority to deny a license to a Mexican investor because the investor is Mexican accords less favorable treatment to a Mexican investor than to a like [United States] investor.

. . .

VI. Analysis of the Issues

214. In this analysis, the Panel declines to examine the motivation for the U.S. decision to continue the moratorium on cross-border trucking services and investment; it confines its analysis to the consistency or inconsistency of that action with NAFTA. The Panel notes that this approach is fully consistent with the practice of the WTO Appellate Body, which in *Japan - Taxes on Alcoholic Beverages*, at 28, and in *Chile - Taxes on Alcoholic Beverages*, para. 62, has declined to inquire into the subjective motivations of government decision-makers, or examine their intent. As the Appellate Body observed in analogous circumstances, in *Chile-Alcoholic Beverages*, "The *subjective* intentions inhabiting the minds of individual legislators or regulators do not bear upon the inquiry, if only because they are not accessible to treaty interpreters."[231]
. . .

A. Interpretation of NAFTA

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217. The objectives of NAFTA are proclaimed in Article 102(1). . . . [The panel quotes NAFTA art. 102(1)(a)-(f).]

218. Article 102(2) provides a mandatory standard for the interpretation of the detailed provisions of NAFTA: "The Parties shall interpret and apply the provisions of this Agreement in the light of its objectives set out in paragraph 1 and in accordance with applicable rules of international law."

219. The objectives develop the principal purpose of NAFTA, as proclaimed in its Preamble, wherein the Parties undertake, *inter alia,* to "create an expanded and secure market for the goods and services produced in their territories."[232] Given these clearly stated objectives and the language of the Preamble, the Panel must recognize this trade liberalization background. As the Panel in *Dairy Products* observed:

> [A]s a free trade agreement, NAFTA has the specific objective of eliminating barriers to trade among the three contracting Parties. The principles and rules through which the

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231. *See also* HERSH LAUTERPACHT, THE DEVELOPMENT OF INTERNATIONAL LAW BY THE INTERNATIONAL COURT 52 (1958) ("Interpretation as a juristic process is concerned with the sense of the word used, and not with the will to use that particular word."); CHARLES C. HYDE, INTERNATIONAL LAW 531 (1945) ("The final purpose of seeking the intention of the contracting states is to ascertain the sense in which terms are employed. It is the contract which is the subject of interpretation, rather than the volition of the parties.").

232. International tribunals have not hesitated to resort to the preamble of a treaty in order to discover the principal object of the treaty, as is contemplated in Article 31 of the Vienna Convention, discussed *infra*, note 231, 235. *See also The Lotus*, P.C.I.J., (1927) Ser.A, No.10, 17; *Free Zones of Upper Savoy and the District of Gex* (Order) (1929), P.C.I.J., Ser. A, No. 22, 12; *Asylum (Colombia, Perú),* I.C.J, (1950) Rep. 266 at 276, 282. *Rights of U.S. Nationals* at 196; D.P. O'CONNELL, INTERNATIONAL LAW 260 (2d ed. 1970).

> objectives of NAFTA are elaborated are identified in NAFTA Article 102(1) as including national treatment, most-favored-nation treatment, and transparency. Any interpretation adopted by the Panel must, therefore, promote rather than inhibit NAFTA's objectives. Exceptions to obligations of trade liberalization must perforce be viewed with caution.[233]

The Panel also notes, however, that the Preamble of NAFTA reflects a recognition that the Parties intended to "preserve their flexibility to safeguard the public welfare."

220. In identifying the rules of interpretation of international law referred to in Article 102(2), the Panel need go no further than the 1969 Vienna Convention on the Law of Treaties.[234] Both Parties agree that the Vienna Convention is appropriate for this purpose,[235] as NAFTA Parties have agreed in the past.[236] The guiding rule of the Vienna Convention is Article 31(1), which provides in pertinent part, "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."

221. Thus, in addition to the ordinary meaning of the terms, interpretation must take into account the context, object and purpose of the treaty.[237] The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes, any agreement relating to the treaty.[238] If necessary, there shall be taken into account, together with the context, any subsequent practice and any relevant rules of international law applicable in the relations between the parties.[239]

222. If these criteria are insufficient, there may then be recourse to supplementary means of interpretation, as provided under Article 32 of the Vienna Convention.[240] The Panel must therefore commence with the identification of the plain and ordinary meaning of the words, in the context in which the words appear and considering them

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233. *In the Matter of Tariffs Applied by Canada to Certain United States Origin Agricultural Products*. CDA 95-2008-01, Final Panel, para. 122 (Dec. 2, 1996). The principle that exceptions to general obligations are to be construed narrowly is well accepted in the interpretation of the GATT and WTO. *See Tuna* (Report of the Panel adopted on Feb. 22, 1982, L/5198-29S/91); *Reformulated Gasoline*, WTO Appellate Body (WT/DS/9, May 20, 1996); *Shrimp* WTO Appellate Body (WT/DS58/AB/R, Oct. 12, 1998); *Thailand-Restrictions on Importation of and Internal Taxes on Cigarettes*, Report of the Panel adopted on Nov. 7, 1990 (DS10/R-37S/200), at 87.

234. "International tribunals have not hesitated to resort to the preamble of a treaty in order to discover the principal objectives of a treaty, and Article 31 of the Vienna Convention treats the preamble as part of the 'context' for purpose of interpretation." For documentation and summary sessions of the Vienna Conference, *see* A/CONF.39/11. For official documents, *see* A/CONF.39/11/Add.2. Text of the Vienna Convention can be found at www.un.org/law/ilc/texts/treaties.htm.

235. "The United States considers the Vienna Convention on the Law of Treaties 1969 to be a valid source of law for this purpose of [interpreting NAFTA]." . . .

236. *Dairy Products*, at paras. 118-121 (applying NAFTA Article 102(2) and Articles 31 and 32 of the Vienna Convention).

237. *Case Concerning the Application of the Convention of 1902 Governing the Guardianship of Infants* (Netherlands v. Sweden) I.C.J. Rep., 1958, 55 at 67.

238. Article 31:2 provides:

> "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."

239. Article 31:3 provides:

> There shall be taken into account, together with the context: (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions; (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.

Article 31:4 states: "A special meaning shall be given to a term if it is established that the parties so intended."

240. Article 32 provides:

> "Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31: (a) leaves the meaning ambiguous or obscure; or b) leads to a result which is manifestly absurd or unreasonable."

in the light of the object and purpose of the treaty.[241] Only if the ordinary meaning of the words established through the study and analysis of the context, seems to contradict the object and purpose of the treaty, may other international rules on interpretation be resorted to for the interpretation of the provision.[242] In this proceeding, the Panel has found it unnecessary to go beyond the dictates of Article 31 of the Vienna Convention.

223. Article 31, like other provisions of the Convention, must be applied in conjunction with Article 26, ... *i.e.*, *Pacta sunt servanda*.[d] The Panel must interpret the treaty provisions in dispute with the understanding that the Parties accept the binding nature of NAFTA and that its obligations shall be performed in good faith. . . .

B. Reservations for Existing Measures and Liberalization Commitments-Annex I

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2. The Panel's Analysis

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239. [T]he Panel finds that implementation of the very concrete Phase-Out provisions of the Reservations in this case is not conditioned by any other element.[264] If the Parties had wished to establish any mode of subsequent acceptance or condition to the liberalization commitments agreed on in the Phase-Out elements of Annex I, they would have or could have used other wording. It is the opinion of the Panel that the Phase-Out provisions in Annex I must prevail over all other elements of Annex I. The United States has failed to demonstrate the existence of any valid legal ground for its non-compliance with NAFTA Liberalization Commitments regarding Land Transportation Services and Investment in Annex I.

240. Under these circumstances, the phase-out obligations of the United States under Annex I with regard to cross-border trucking services and investment prevail unless there is some other provision of NAFTA that could supersede these obligations. It is to those other provisions that the Panel now turns.

C. Services

241. The key issue in services, in the view of the Panel, is whether the United States was in breach of Articles 1202 (national treatment for cross-border services) and 1203 (most-favored-nation treatment for cross-border services) of NAFTA by failing to lift its moratorium on the processing of applications by Mexican owned trucking firms for

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241. "It is impossible to say that an article is clear before its object and end is determined. Only when the object is established can one ascertain that the natural sense of the terms used remains within or exceeds the intention as disclosed." Judge Anzilotti in *Interpretation of the Convention of 1919 Concerning the Employment of Women during the Night,* P.C.I.J., Ser. A/B, No. 50 (1932). *Ambatielos Case*, I.C.J. Rep., 1952, 28 at 60. "Hence the idea that there is a natural meaning to words is delusive". D.P. O'Connell, op.cit., 254. *Anglo-Iranian Oil Case*, I.C.J. Rep., 1952, 104. Lord McNair, *The Law of Treaties*, 1961, 364. HERBERT W. BRIGGS, THE LAW OF NATIONS 877-899 (2d ed.); CHARLES G. FENWICK, INTERNATIONAL LAW 535-540 (4th ed.).

242. This approach has been clearly endorsed by the International Court of Justice:

> The Court considers it necessary to say that the first duty of a tribunal which is called upon to interpret and apply the provisions of a treaty, is to endeavour to give effect to them in their natural and ordinary meaning in the context in which they occur. If the relevant words in their natural and ordinary meaning make sense in their context, that is an end of the matter.

Competence of the General Assembly for the Admission of a State to the United Nations, Advisory Opinion, March 1950, I.C.J. Rep., 4 at 8.

d. *See* note a, *supra* (discussing *pacta sunt servanda*).

264. "Conditions should be implied only with great circumspection; for if they are implied too readily, they would become a serious threat to the sanctity of a treaty." McNair, op.cit. 436.

authority to operate in the U.S. border states. Given the expiration on December 17, 1995 of the Annex I reservation that the United States took to allowing cross-border trucking, the maintenance of the moratorium must be justified either under the language of Articles 1202 and 1203, or by some other provision of NAFTA, such as those found in . . . Article 2101 (general exceptions). . . . [T]he Parties rest their positions in large part on their interpretation of Articles 1202, 1203 and 2101.

1. Positions of the Parties

242. The United States argues that Mexico's truck transportation regulatory system does not maintain the same rigorous standards as the systems in the United States and Canada, and that therefore the "in like circumstances" language in Article 1202 means that "service providers [in Mexico] may be treated differently in order to address a legitimate regulatory objective." Further, since the Canadian regulatory system is "equivalent" to that of the United States, it is not a violation of most-favored-nation treatment under Article 1203 for the United States to treat Canadian trucking firms which are "in like circumstances" vis-a-vis U.S. trucking firms in a more favorable manner than Mexican trucking firms. The United States also suggests the applicability of Article 2101, which provides a general exception to other NAFTA obligations and may be invoked for " measures necessary to secure compliance with laws or regulations . . . relating to health and safety and consumer protection." . . .

243. Mexico vigorously contests the U.S. interpretation of Articles 1202 and 1203, without contending that the Mexican regulatory system is equivalent to that of the United States and Canada.[268] According to Mexico, Mexican trucking firms are entitled to the same rights as U.S. carriers under U.S. law, that is "consideration on their individual merits and a full opportunity to contest the denial of operating authority." Any other approach is a violation of Articles 1202 and 1203. During NAFTA negotiations, both governments understood that motor carriers would have to comply fully with the standards *of the country in which they were providing service*. However, the obligations of the Parties were not made contingent upon completion of the standards-capability work program or the adoption of an identical regulatory system in Mexico. . . . Thus, the blanket denial of access is not justified under any provision of NAFTA.

244. Canada, which exercised its right to participate in accordance with Article 2013, essentially agrees with Mexico, insisting that the major issue in interpreting Article 1202 is a comparison between a foreign service provider providing services cross-border (here, from Mexico into the United States), and a service provider providing services domestically. Canada also contends that a "blanket" refusal by the United States to permit Mexican carriers to obtain operating authority to provide cross-border truck services would necessarily be less favorable than the treatment accorded to U.S. truck services providers in like circumstances. . . .

245. The Panel notes that despite suggestions to the contrary,[276] no significant disagreement exists as to the facts as they relate to the truck regulatory systems in the

268. Mexico also argues that adoption of an identical motor carrier regulatory system cannot properly be made a condition of NAFTA implementation. . . .

276. On May 16, 2000, the United States requested the Panel to seek the written report of a scientific review board under NAFTA, Article 2015. After providing both Parties an opportunity to submit additional comments, the Panel, on July 10, 2000, declined to request a scientific review board.

United States, Canada and Mexico. The United States has spent a considerable portion of its submissions explaining the nature of the U.S. regulatory system, the similarities of the Canadian regulatory system, and the differences (and perceived deficiencies) in the Mexican system. The United States argues that the Mexican regulatory system is far less effective in assuring safe drivers and equipment through mandatory inspections, driver licensing, logbooks and other procedures, than the systems currently in use in the United States and Canada: "adequate procedures are not yet in place [in Mexico] to ensure U.S. highway safety." However, the Parties differ regarding the implications of the differences in regulatory standards. The United States and Mexico have engaged in extensive consultations concerning truck transportation services and compliance with regulatory objectives. This fact is amply demonstrated in the record of this case. This, of course, is not the issue. The issue is whether the decision by the United States not to consider applications from Mexican service providers *as a group* is consistent with the applicable NAFTA obligations of the United States.

2. The Panel's Analysis

246. Article 1202 provides in pertinent part: "1. Each Party shall accord to service providers of another Party treatment no less favorable than it accords, *in like circumstances*, to its own service providers." Similarly, Article 1203 states: "Each Party shall accord to service providers of another Party treatment no less favorable than it accords, *in like circumstances*, to service providers of any other Party or of a non-Party."

247. Articles 1202 and 1203 represent the obligations of national treatment (equality of treatment between foreigners and nationals) and most-favored-nation treatment (equality of treatment among foreign nationals of different states). The United States and Mexico do not question the legal force of these obligations. In its most succinct terms, the disagreement between the United States on the one hand, and Mexico and Canada on the other, is over whether the "in like circumstances" language (or some other limitation on or exception to national treatment and most-favored-nation treatment) permits the United States to deny access to all Mexican trucking firms on a blanket basis, regardless of the individual qualifications of particular members of the Mexican industry, unless and until Mexico's own domestic regulatory system meets U.S. approval. Alternatively, the issue can be stated as whether or not the United States is required to examine Mexican carriers seeking operating authority in the United States on an individual basis to determine whether each individual applicant meets (or fails to meet) the standards for carriers operating in the United States. This disagreement in turn rests on the interpretation and scope of the "in like circumstances" language, that is, whether the comparison may be applied to "service providers" on a blanket country-by-country basis or instead must be applied to individual service provider applicants.

248. Article 1202 requires each Party to accord to service providers of another Party treatment that is no less favorable than it accords, in like circumstances, to its own service providers. Given that under U.S. law the United States treats operating authority applications received from U.S. (and Canadian) -owned and -domiciled carriers on an individual basis, the blanket refusal of the United States to review applications for operating authority from Mexican trucking service providers on an individual basis suggests inconsistency with the U.S. national treatment obligation (and from most-favored-nation treatment, given that Canadian carriers are also treated on an individual basis).

249. The Panel, in interpreting the phrase "in like circumstances" in Articles 1202

and 1203, has sought guidance in other agreements that use similar language. The Parties do not dispute that the use of the phrase "in like circumstances" was intended to have a meaning that was similar to the phrase "like services and service providers," as proposed by Canada and Mexico during NAFTA negotiations. Also, the United States contends, and Mexico does not dispute, that the phrase "in like circumstances" is not substantively different from the phrase "in like situations," as used in bilateral investment treaties.

Most significantly, no Party asserts that the use of the phrase "in like circumstances" in NAFTA Chapter Twelve was intended to have a different meaning than it did in the United States-Canada Free Trade Agreement (FTA). Mexico notes that the "immediate source" of the "in like circumstances" language in Articles 1202 and 1203 of NAFTA was the FTA. The United States has referred to elaborating language in the FTA on the national treatment obligation to support the interpretation of the phrase used in NAFTA to permit differential treatment where appropriate to meet legitimate regulatory objectives. Again, the Parties do not differ on the general principle that differential treatment may be appropriate and consistent with a Party's national treatment obligations.

250.FTA Article 1402 is thus instructive. It provides a more detailed elaboration of the national treatment requirement for services than is found in NAFTA:

> 1. Subject to paragraph 3, each Party shall accord to persons of the other Party treatment no less favourable [sic] than that accorded in like circumstances to its persons with respect to the measures covered by this Chapter [services, investment and temporary entry].
>
> . . .
>
> 3. Notwithstanding paragraphs 1 and 2, the treatment a Party accords to persons of the other Party may be different from the treatment the Party accords its persons provided that:
>
> a) the difference in treatment is no greater than that necessary for prudential, fiduciary, health and safety, or consumer protection reasons;
>
> b) such different treatment is equivalent in effect to the treatment accorded by the Party to its persons for such reasons; and
>
> c) prior notification of the proposed treatment has been given in accordance with Article 1803.

The provision in the FTA also imposed the burden of establishing the consistency of the differential treatment with the above requirements on the party proposing or according different treatment.[286]

251.The Panel notes that the FTA language provides a more detailed and specific limitation on any Party's right to depart from its national treatment obligations than is found in the shorter text of Article 1202. However, the Panel observes that similar national treatment obligations have been interpreted, in the GATT *Section 337* case, to permit the imposition of some requirements concerning imports that are different from those imposed on domestic products;[287] *identical* treatment is not necessarily required with regard to treatment of intellectual property violations relative to imported goods compared to domestically produced goods. Yet, the Panel in *Section 337* also recognized that formally identical requirements for imports may in fact provide less

286. FTA, Art. 1402.4.

287. *U.S. - Section 337 of the Tariff Act of 1930*, L/6439 - 36S/345 (Nov. 7, 1989) (Panel Report), para. 5.31.

favorable treatment in specific circumstances.[288]

252.The Panel next examined the applicable legal provisions of NAFTA to determine, with respect to the provisions governing cross-border truck transportation services from Mexico into the United States, what constitutes the service providers of Mexico, on the one hand, and the service providers of the United States providing trucking services in the United States, on the other. Article 1213 defines a service provider of a Party to be a *person* of a Party that seeks to provide or provides a service. Article 201 defines a person of a Party to be a national or an enterprise of a Party, and defines an enterprise of a Party to be an entity constituted or organized under applicable law. Given these definitions, the Panel considered the undisputed facts in the record that the essential *service* in question involves the commercial transportation of goods from Mexico to points in the United States by service providers of Mexico.

253. This essential service presently includes: (1) trucking services in which a tractor and trailer provide service from a point in Mexico to a point in the United States and (2) trucking services in which a trailer from Mexico is transferred from a Mexican tractor to a U.S. tractor in a Border Commercial Zone from which the service continues to a point in the United States. Additionally, the relevant trucking services also include the transit of Mexican trucks from Mexico through the United States to Canada. Those who provide or seek to provide such services are the relevant "service providers." The service providers of the United States are U.S. owned or domiciled trucking firms. The treatment of these U.S. domestic trucking service providers by U.S. regulatory authorities is the basis of comparison with the treatment by the United States of Mexican trucking service providers seeking operating authority in the United States, in determining whether the United States is providing national treatment.

254. It is not disputed that the United States prohibits consideration of applications from most Mexican service providers to supply truck transportation services from Mexico to points in the United States outside the border commercial zone. Yet, the obligation of NAFTA Article 1202 is to provide no less favorable treatment to service providers of Mexico. It appears from uncontested facts that the United States is not doing so. The United States has permitted roughly 150 Mexican-domiciled carriers who claim U.S. majority ownership, five Mexican-domiciled, Mexican owned carriers grandfathered under U.S. law, and one Mexican-domiciled, Mexican owned carrier transiting the United States to reach Canada, to operate freely in the United States despite alleged deficiencies in the Mexican truck regulatory system.[290] Similarly, until 1999, four years after restrictions on cross-border trucking were to be lifted under Annex I, the United States permitted U.S. motor carriers to lease Mexican trucks and drivers for operations in the United States.[291] Certain Mexican drayage carriers are permitted to provide services only within the narrow border commercial zones, and are wholly prohibited from providing service to other points in the United States. These carriers are subjected

288. *Id.,* para. 5.11.

290. . . . The United States argues that those apparent exceptions to USDOT policy are permitted because they are based on non-safety related reasons and because USDOT lacks the legal authority to halt them. . . . However, there is no evidence in the record suggesting that the President made any effort to obtain legislation to halt these long standing-practices, with the exception of closing the loophole which permitted U.S. trucking firms to lease Mexican trucks and drivers for service in the United States.

291. This so-called "loophole" was closed by Section 219 of the Motor Carrier Safety Improvement Act of 1999. Mexico argues that this was for anti-competitive reasons. . . . The United States contends it was for safety reasons. . . . However, for whatever reason, the practice was used until very recently, and the United States has not provided the Panel with any evidence of specific safety problems arising out of the practice.

to differential treatment, for commercial reasons and because of U.S. safety concerns.[292]

255. However, in all other circumstances comprising Mexican trucking service providers–presumably hundreds or even thousands of firms–those Mexican service providers have been denied access to the U.S. border states since December 17, 1995, despite the requirements of Annex I and Articles 1202 and 1203.

256. Thus, the provision of no less favorable treatment to these very limited Mexican service providers fails to satisfy the obligation to provide no less favorable treatment to *other* trucking service providers of Mexico, who remain subject to the moratorium. The U.S. blanket refusal to review requests for operating authority from other Mexican trucking firms, because of safety concerns, is inconsistent with these prior exceptions to the moratorium, as well as with U.S. treatment of U.S. domestic trucking service providers.

257. Therefore, absent other justification, the moratorium imposed by the United States on the processing of applications since December 17, 1995, would constitute a *de jure* violation of the national treatment obligation in Article 1202. However, the United States asserts justification under the terms "like circumstances," and the proposed interpretation to include differential treatment for legitimate regulatory objectives related to safety.

258. The Panel has noted that the phrase "like circumstances" may properly include differential treatment under the conditions specified in the FTA Article 1402, as discussed earlier. However, the Panel is also aware of Chapter One, Article 102. Article 102(2) of NAFTA clearly states that "The Parties shall interpret and apply the provisions of this Agreement in the light of its objectives set out in paragraph 1 and in accordance with applicable rules of international law." The first of NAFTA's listed objectives is to "eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties."[293] These objectives are elaborated more specifically through the principles and rules in NAFTA, including national treatment. Further, the provisions of the Agreement are required to be interpreted in light of the objectives and applicable rules of international law. Given these requirements, and the use of the same term in the FTA, the Panel is of the view that the proper interpretation of Article 1202 requires that differential treatment should be no greater than necessary for legitimate regulatory reasons such as safety, and that such different treatment be equivalent to the treatment accorded to domestic service providers. With regard to objectives, it seems unlikely to the Panel that the "in like circumstances" language in Articles 1202 and 1203 could be expected to permit maintenance of a very significant barrier to NAFTA trade, namely a prohibition on cross-border trucking services.

259. Similarly, the Panel is mindful that a broad interpretation of the "in like circumstances" language could render Articles 1202 and 1203 meaningless. If, for example, the regulatory systems in two NAFTA countries must be substantially identical before national treatment is granted, relatively few service industry providers could ultimately qualify. Accordingly, the Panel concludes that the U.S. position that the "in

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292. The United States has argued that the safety record of Mexican drayage haulers is seriously deficient compared to U.S. trucks operating nationwide. . . . Mexico has admitted that the drayage haulers have used equipment in relatively poor condition. . . . However, Mexico argues that a comparison between Mexican drayage haulers and U.S. long-haul trucking firm safety records is misleading because the short distance drayage haulers do not have a self-interest in maintaining the quality of equipment that they would have if engaged in long-haul freight operations. . . . Neither argument is overly persuasive, nor directly pertinent to the Panel's analysis of the law.

293. NAFTA, Art. 102(1)(a).

like circumstances" language permits continuation of the moratorium on accepting applications for operating authority in the United States from Mexican owned and domiciled carriers is an overly-broad reading of that clause.

260. The United States also suggests that Article 2101 allows the United States to refuse to accept applications from Mexican trucking service providers because of safety concerns. The Panel's view that the "in like circumstances" language, as an exception, should be interpreted narrowly, applies equally to Article 2101. Here, the GATT/WTO history, liberally cited by the Parties, and the FTA language, noted earlier, are both instructive. Although there is no explicit language in Chapter Twelve that sets out limitations on the scope of the "in like circumstances" language, the general exception in Article 2101:2 invoked by the United States closely tracks the GATT Article XX language, and is similar to the FTA proviso limiting exceptions to national treatment to situations where "the difference in treatment is no greater than necessary for . . . health and safety or consumer protection reasons."[294]

261. Thus, Article 2101:2 provides in pertinent part:

> Provided that such measures are not applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on [international] trade between the Parties, nothing in . . . Chapter Twelve (Cross-Border Trade in Services) . . . shall be construed to prevent the adoption of enforcement by any Party of measures necessary to secure compliance with laws or regulations that are not inconsistent with the provisions of this Agreement, including those relating to health and safety and consumer protection.

262. Under Article 2101, therefore, safety measures adopted by a Party–such as the moratorium on accepting applications for U.S. operating authority from Mexican trucking service providers–may be justified only to the extent they are "necessary to secure compliance" with laws or regulations that are otherwise consistent with NAFTA. Here again, the GATT/WTO jurisprudence proves helpful in determining what "necessary" means.

263. The "necessary to secure compliance" language in GATT Article XX has been interpreted strictly in numerous GATT/WTO decisions, including *United States–Section 337 of the Tariff Act of 1930*,[295] *Canada–Certain Measures Concerning Periodicals,*[296] *United States–Standards for Reformulated and Conventional Gasoline,*[297] and *United States–Import Prohibition on Certain Shrimp and Shrimp Products.*[298] . . .

268. [T]here is no evidence in the record that the United States considered more acceptable, less trade restrictive, alternatives, except to the extent that it does so for specific Mexican service providers exempted from the moratorium.

269. The Panel is generally in agreement with Mexico that, consistent with the GATT/WTO history and the text of Article 2101, in order for the U.S. moratorium on processing of Mexican applications for operating authority to be NAFTA-legal, any moratorium must secure compliance with some other law or regulation that does not discriminate; be necessary to secure compliance; and must not be arbitrary or

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294. USCFTA, Art. 1403.3(a).
295. [GATT] Panel Report adopted Nov. 7, 1989, BISD/345.
296. [WTO] Panel Report adopted Mar. 14, 1957, WT/DS31/R.
297. [WTO] Panel Report adopted May 20, 1996, WT/DS2/R.
298. [WTO] Panel Report adopted Oct. 12, 1998, WT/DS58/AB/R.

unjustifiable discrimination or a disguised restriction on trade.[304]

270. Also, if under the GATT/WTO jurisprudence a Party is "bound to use, among the measures reasonably available to it, that which entails the least degree of inconsistency with other . . . provisions," in this NAFTA case, the United States has failed to demonstrate that there are no alternative means of achieving U.S. safety goals that are more consistent with NAFTA requirements than the moratorium. In fact, the application and use of exceptions would appear to demonstrate the existence of less-restrictive alternatives. . . .

276. With regard to most-favored-nation treatment under Article 1203, essentially the same considerations are relevant as with national treatment under Article 1202, discussed in detail above. If the "in like circumstances" language means that the foreign regulatory system must be equivalent or identical to the U.S. system, and the United States has concluded that the Canadian system meets this criterion, the United States would be justified in discriminating in favor of Canadian trucking firms. However, if "in like circumstances" does not permit this treatment, Article 1203 is violated as well as Article 1202, since U.S. and Canadian carriers are treated in the same manner (individually) while Mexican carriers are treated differently. This is true with regard to any possible departures from most-favored-nation treatment based on other provisions of NAFTA, such as Article 2101, again as discussed earlier. . . .

D. Investment

279. The issue before this Panel with regard to investment is to determine whether the failure by the U.S. government to take appropriate regulatory actions to eliminate the moratorium on Mexican investments in companies providing international transportation by land constitutes a breach of Articles 1102, 1103 and 1104 of NAFTA. . . .

286. . . . Mexico has asserted and the United States has conceded that U.S. laws and regulations authorize the Department of Transportation to deny a newly created U.S.-domiciled carrier with Mexican investment the opportunity to obtain operating authority. Current U.S. regulatory policy also prohibits the acquisition of an existing U.S. carrier that already had operating authority, because of the requirement for the applicant to certify that the applicant is not a Mexican national, nor owned or controlled by Mexican nationals. Under these circumstances, an application filed by a Mexican carrier would be futile. . . .

289. Long-established doctrine under the GATT and WTO holds that where a measure is inconsistent with a Party's obligations, it is unnecessary to demonstrate that the measure has had an impact on trade. For example, GATT Article III (requiring national treatment of goods) is interpreted to protect expectations regarding competitive opportunities between imported and domestic products and is applicable even if there have been no imports.[323] Moreover, it is well-established that parties may challenge

304. [*S*]*ee Section 337*, para. 6.31.

323. For example, a GATT Working Party Report on Brazilian Internal Taxes noted: "[the majority of the members of the Working Party] took the view that the provisions of the first sentence of Article III, paragraph 2, were equally applicable, whether imports from other contracting parties were substantial, small or non-existent." *See* WORLD TRADE ORGANIZATION, ANALYTICAL INDEX: GUIDE TO GATT LAW AND PRACTICE 128 (6th ed. 1995). *See also Japan - Taxes on Alcoholic Beverages*, AB-1996-2 (Appellate Body) (4 Oct. 1996) at Section F.

> "[T]he purpose of Article III [which requires national treatment of goods] "is to ensure that internal measures 'not be applied to imported or domestic products so as to afford protection to domestic production'." Toward this end, Article III obliges Members . . . to provide equality of competitive conditions for imported products in relation to domestic products. . . . [I]t is irrelevant that "the trade effects"

measures mandating action inconsistent with the GATT regardless of whether the measures have actually taken effect.[324]

290. Furthermore, Article 2004 of NAFTA allows the Parties to initiate the dispute settlement procedures with "respect to the *avoidance* or settlement of all disputes between the Parties regarding the interpretation or application of [the treaty], or wherever a Party considers that an actual *or proposed* measure of another Party is *or would be* inconsistent with the obligations of [the treaty]." The Panel is not faced with a case brought in the context of NAFTA Annex 2004, which authorizes a Party to have recourse to the dispute settlement procedure where it considers that benefits one Party could reasonably have expected to accrue to it have been nullified or impaired by a measure that is not inconsistent with NAFTA.[325]

291. The Panel finds that Mexico has . . . establish[ed] a *prima facie* case of inconsistency with NAFTA. The deprivation of the right to obtain operating authority to U.S. companies owned or controlled by Mexican nationals and the prohibition on allowing Mexican investors to acquire U.S. companies that already have operating authority, on its face, violates the straight-forward provisions of NAFTA Articles 1102 and 1103.

292. Because the United States expressly prohibits the above mentioned investment, this Panel finds such prohibitions as inconsistent with NAFTA, even if Mexico cannot identify a particular Mexican national or nationals that have been rejected. A blanket refusal to permit a person of Mexico to establish an enterprise in the United States to provide truck services for the transportation of international cargo between points in the United States is, on its face, less favorable than the treatment accorded to U.S. truck service providers in like circumstances, and is contrary to Article 1102. Where there have been direct violations of NAFTA, as in this case, there is no requirement for the Panel to make a finding that benefits have been nullified or impaired; it is sufficient to find that the U.S. measures are inconsistent with NAFTA. . . .

294. Accordingly, the Panel determines that in connection with investments by Mexican nationals in U.S. companies established to provide trucking services for the transportation of international cargo between points in the United States, no circumstances exist that would justify differential treatment from U.S. (or Canadian) investors and investments under NAFTA's Chapter Eleven national treatment and most-favored-nation obligations.

VII. FINDINGS, DETERMINATIONS AND RECOMMENDATIONS

A. Findings and Determinations

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of the tax differential between imported and domestic products, as reflected in the volumes of imports, are insignificant or even non-existent; Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products."

324. *See, e.g.*, *United States - Taxes on Petroleum and Certain Imported Substances,* in which the Panel stated: "The general prohibition of quantitative restrictions under Article XI . . . and the national treatment obligation of Article III . . . have essentially the same rationale, namely to protect expectations of the contracting parties as to the competitive relationship between their products and those of the other contracting parties. Both Articles are not only to protect current trade but also to create the predictability needed to plan future trade. That objective could not be attained if contracting parties could not challenge existing legislation mandating actions at variance with the General Agreement until the administrative acts implementing it had actually been applied to their trade." 34S/136 (adopted June 17, 1987), at 160, para. 5.5.5, *reprinted in* Analytical Index at 133.

325. Annex 2004, *emphasis added*. Annex 2004 was intended to mirror the GATT practice of allowing claims for "non-violation nullification or impairment" of benefits.

295. On the basis of the analysis set out above, the Panel unanimously determines that the U.S. blanket refusal to review and consider for approval any Mexican-owned carrier applications for authority to provide cross-border trucking services was and remains a breach of the U.S. obligations under Annex I (reservations for existing measures and liberalization commitments), Article 1202 (national treatment for cross-border services), and Article 1203 (most-favored-nation treatment for cross-border services) of NAFTA. An exception to these obligations is not authorized by the "in like circumstances" language in Articles 1202 and 1203, or by the exceptions . . . under Article 2101.

296. The Panel unanimously determines that the inadequacies of the Mexican regulatory system provide an insufficient legal basis for the United States to maintain a moratorium on the consideration of applications for U.S. operating authority from Mexican-owned and/or domiciled trucking service providers.

297. The Panel further unanimously determines that the United States was and remains in breach of its obligations under Annex I (reservations for existing measures and liberalization commitments), Article 1102 (national treatment), and Article 1103 (most-favored-nation treatment) to permit Mexican nationals to invest in enterprises in the United States that provide transportation of international cargo within the United States.

B. Recommendations

299. The Panel recommends that the United States take appropriate steps to bring its practices with respect to cross-border trucking services and investment into compliance with its obligations under the applicable provisions of NAFTA.

300. The Panel notes that compliance by the United States with its NAFTA obligations would not necessarily require providing favorable consideration to all or to any specific number of applications from Mexican-owned trucking firms, when it is evident that a particular applicant or applicants may be unable to comply with U.S. trucking regulations when operating in the United States. Nor does it require that all Mexican-domiciled firms currently providing trucking services in the United States be allowed to continue to do so, if and when they fail to comply with U.S. safety regulations. The United States may not be required to treat applications from Mexican trucking firms in exactly the same manner as applications from U.S. or Canadian firms, as long as they are reviewed on a case by case basis. U.S. authorities are responsible for the safe operation of trucks within U.S. territory, whether ownership is U.S., Canadian or Mexican.

301. Similarly, it may not be unreasonable for a NAFTA Party to conclude that to ensure compliance with its own local standards by service providers from another NAFTA country, it may be necessary to implement different procedures with respect to such service providers. Thus, to the extent that the inspection and licensing requirements for Mexican trucks and drivers wishing to operate in the United States may not be "like" those in place in the United States, different methods of ensuring compliance with the U.S. regulatory regime may be justifiable. However, if in order to satisfy its own legitimate safety concerns the United States decides, exceptionally, to impose requirements on Mexican carriers that differ from those imposed on U.S. or Canadian carriers, then any such decision must (a) be made in good faith with respect to a legitimate safety concern and (b) implement differing requirements that fully conform with all relevant NAFTA provisions.

302. These considerations are inapplicable with regard to the U.S. refusal to permit Mexican nationals to invest in enterprises in the United States that provide transportation of international cargo within the United States, since both Mexico and the United States have agreed that such investment does not raise issues of safety.

NOTES AND QUESTIONS

1. In paragraph 10 of its initial report, the NAFTA panel noted the United States argument that *WTO practice* would avoid inquiring into the intent of parties accused of WTO violations. Is corresponding WTO practice relevant in a case involving the interpretation of the NAFTA? Does it make a difference that all three NAFTA members are also WTO members? What about Mexico's invocation (in paragraphs 133, 136-139) of practice under the general exceptions of GATT art. XX? What is the panel's position on the relevance of party intent? (*See* paragraph 214.)

2. Review NAFTA art. 2013. On what theory does Canada–which has benefitted from the U.S. transportation policy at issue–have a right to participate in a dispute between the United States and Mexico? Whose side is Canada on in this dispute? (*See* paragraphs 11, 195-197, 244.) Why? If Canada intends to "avoid[ ] comment on the specific facts of the case" (paragraph 195), what role *does* it play in this dispute?

3. In paragraphs 105-108, the NAFTA panel discusses a teleological argument raised by Mexico, relying on *Tariffs Applied by Canada to Certain United States Origin Agricultural Products*, to the effect that the legality of a NAFTA member's action must be assessed on the basis of the generally stated objectives of the treaty. Is this a convincing argument? Should general, hortatory language in a treaty control the technical application of specific, detailed provisions? And is the *Tariffs* decision a precedent binding on subsequent panels dealing with specific disputes different from the previous one? How persuasive is the U.S. response, discussed in paragraph 158? What is the panel's position on this issue? (*See* paragraphs 217-222, 258.) Does the panel's position favor Mexico or the United States in the context of this dispute?

4. Who has the better argument on the significance of the term "in like circumstances" in NAFTA arts. 1202 and 1203, Mexico (paragraphs 120-125) or the United States (paragraphs 160-171)? What is the panel's view on this issue? (*See* paragraphs 246-259.)

5. In paragraph 143, reference is made to a possible argument based on "a non-violation nullification or impairment of benefits." What kind of argument is this, and how does it differ from Mexico's primary argument–that the United States is violating national treatment and most-favored-nation obligations under the NAFTA? If Mexico can obtain relief on a "non-violation" basis, why go to all the trouble of arguing that the United States has violated the NAFTA? And what do you think of the U.S. response to the "non-nullification" argument (paragraphs 190-194)?

6. Consider the views expressed by the panel on the applicability of the general exceptions of art. 2101 (paragraphs 260-263, 268-270). Is the panel accurately reading the GATT/WTO jurisprudence on the subject?[1] What scope is available to the general

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1. For discussion of the scope of general exceptions in GATT art. XX, see Appellate Body report in *US - Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, which limited the scope and applicability of the specific exceptions listed in GATT art. XX by reference to the language of the *chapeau* of Article XX. The technical term *chapeau* refers to the "hat" or opening or introductory text of a provision that then breaks out separately identified subheadings or provisions. This approach to the interpretation of provisions of the GATT–and specifically article XX, which provides general

exceptions under the panel's interpretation? To what extent could the United States validly invoke art. 2101?

7. In light of the fact that no Mexican firm appears to be ready to invest in U.S. trucking, isn't the dispute over U.S. treatment of investment under NAFTA arts. 1102-1104 purely abstract–in U.S. domestic terminology, "not ripe," or not a "case or controversy"? How does the panel resolve this issue? (*See* paragraphs 279, 286, 289-294, 302.)

8. Would it have made a difference to the outcome in this case if the United States had processed individual applications from Mexican trucking firms, and in each case made specific negative determinations about the safety of the applicant's operations? Would it make a difference if each such application was then individually denied? Consider in this regard the panel's remarks in paragraph 300.

9. Since the "blanket" approach of the United States with respect to Mexican trucking firms seems to be an important failing in the U.S. position in this dispute, does the outcome in this case suggest that the United States should reconsider the "blanket" *favorable* treatment that it had extended to *Canadian* trucking firms? In light of its remarks in paragraph 301, what do you think the panel would say about this suggestion?

10. Although the excerpted panel report was only an "initial" report, the United States appears to have conceded the dispute. Does the following presidential memorandum in fact resolve the outstanding issues? More importantly, in light of the memorandum, what happens next?

Memorandum for the Secretary of Transportation: Determination Under the Interstate Commerce Commission Termination Act of 1995 (November 27, 2002)

67 Fed. Reg. 71,795 (2002)

Section 6 of the Bus Regulatory Reform Act of 1982, Public Law 97-261, 96 Stat. 1103, imposed a moratorium on the issuance of certificates or permits to motor carriers domiciled in, or owned or controlled by persons of, a contiguous foreign country and authorized the President to modify the moratorium. The Interstate Commerce Commission Termination Act of 1995 (ICCTA), Public Law 104-88, 109 Stat. 803, maintained these restrictions, subject to modifications made prior to the enactment of the ICCTA, and empowered the President to make further modifications to the moratorium.

Pursuant to 49 U.S.C. 13902(c)(3), I modified the moratorium on June 5, 2001, to allow motor carriers domiciled in the United States that are owned or controlled by persons of Mexico to obtain operating authority to transport international cargo by truck between points in the United States and to provide bus services between points in the United States.

The North American Free Trade Agreement (NAFTA) established a schedule for liberalizing certain restrictions on the provision of bus and truck services by Mexican-domiciled motor carriers in the United States. Pursuant to 49 U.S.C. 13902(c)(3), I hereby determine that the following modifications to the moratorium are consistent with obligations of the United States under NAFTA and with our national transportation policy and that the moratorium shall be modified accordingly.

First, qualified motor carriers domiciled in Mexico will be allowed to obtain operating authority to transport passengers in cross-border scheduled bus services. Second, qualified

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exceptions from GATT obligations–is a well-established principle in GATT practice.

motor carriers domiciled in Mexico will be allowed to obtain operating authority to provide cross-border truck services. The moratorium on the issuance of certificates or permits to Mexican-domiciled motor carriers for the provision of truck or bus services between points in the United States will remain in place. These modifications shall be effective on the date of this memorandum.

Furthermore, pursuant to 49 U.S.C. 13902(c)(5), I hereby determine that expeditious action is required to implement this modification to the moratorium. Effective on the date of this memorandum, the Department of Transportation is authorized to act on applications, submitted by motor carriers domiciled in Mexico, to obtain operating authority to provide cross-border scheduled bus services and cross-border truck services. In reviewing such applications, the Department shall continue to work closely with the Department of Justice, the Office of Homeland Security, and other relevant Federal departments, agencies, and offices in order to help ensure the security of the border and to prevent potential threats to national security.

Motor carriers domiciled in Mexico operating in the United States will be subject to the same Federal and State laws, regulations, and procedures that apply to carriers domiciled in the United States. These include safety regulations, such as drug and alcohol testing requirements; insurance requirements; taxes and fees; and other applicable laws and regulations, including those administered by the United States Customs Service, the Immigration and Naturalization Service, the Department of Labor, and Federal and State environmental agencies.

11. *Revenge of free trade*? At about the same time the presidential memorandum was issued, the United States announced that, despite protests from Mexico that its farmers were being swamped by (allegedly) subsidized U.S. food, it would not renegotiate the free trade agreement with Mexico to address this issue.[2] Mexican officials were warning that the Mexican economy would suffer significantly when tariffs on many U.S. farm products were lifted in January 2003 under NAFTA, and that millions of Mexicans might be forced to migrate to the United States as a result.

12. *Revenge of Environmental Policy*? U.S. interests opposed to free access for Mexican trucking firms to the U.S. market (including the Teamsters) immediately mounted a challenge in U.S. courts, based on U.S. environmental law. What implications does the following decision by the Ninth Circuit have for the NAFTA dispute?

PUBLIC CITIZEN v. DEPARTMENT OF TRANSPORTATION

— F.3d —, 2003 WL 124764 (9th Cir. 2003)

WARDLAW, Circuit Judge.

Petitioners challenge the Department of Transportation's failure to conduct the requisite environmental analyses prior to promulgating three regulations, the combined effect of which will permit Mexico-domiciled motor carriers to operate within the United States beyond the current limited border zones, thus fulfilling the United States' obligations under the North American Free Trade Agreement. Upon completion of a preliminary Environmental Assessment for two of the three regulations, the Department of Transportation decided that there was no need for further environmental analysis. Petitioners claim that the Department of Transportation's failure to prepare an in-depth Environmental Impact Statement for all three regulations violates the National Environmental Policy Act of 1969,

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2. *Mexico: U.S. Won't Renegotiate Trade Deal*, N.Y. Times News Serv., Nov. 26, 2002.

and that its further failure to conduct a "conformity determination" to ensure that the regulations do not disrupt applicable State Implementation Plans violates the Clean Air Act. Although we agree with the importance of the United States' compliance with its treaty obligations with its southern neighbor, Mexico, such compliance cannot come at the cost of violating United States law. Because we conclude that the Department of Transportation acted without regard to well-established United States environmental laws, we grant the petitions.

I. LEGAL BACKGROUND

Before proceeding to the regulations at issue, it is useful to examine the legal and regulatory context in which they were promulgated. These regulations can only be considered against the historical backdrop of the National Environmental Policy Act of 1969, Pub.L. No. 91-190, 83 Stat. 852 (1970) (codified as amended at 42 U.S.C. §§ 4321-4370f) ("NEPA"), the Clean Air Act, 42 U.S.C. §§ 7401-7671q ("CAA"), and the North American Free Trade Agreement, Dec. 17, 1992, U.S.-Can.-Mex., 32 I.L.M. 289 (chs.1-9), 32 I.L.M. 605 (chs.10-22) (1993) ("NAFTA").

A. National Environmental Policy Act of 1969

On January 1, 1970, President Richard Nixon signed NEPA into law. Although various state and federal environmental measures had been in place for decades, this statute marked the first nationwide comprehensive approach to regulating the interaction between Americans and their environment. Prompted by a series of environmental crises in the late 1960s, NEPA's sweeping reach reflected Congress's conviction that "our Nation's present state of knowledge, our established public policies, and our existing governmental institutions are not adequate to deal with the growing environmental problems and crises the Nation faces." S.Rep. No. 91-296, at 4 (1969).

Such broad policy creation was also reflected in the statute's first section, containing the congressional declaration of purpose:

> The purposes of this chapter are: To declare a national policy which will encourage productive and enjoyable harmony between man and his environment; to promote efforts which will prevent or eliminate damage to the environment and biosphere and stimulate the health and welfare of man; to enrich the understanding of the ecological systems and natural resources important to the Nation; and to establish a Council on Environmental Quality.

42 U.S.C. § 4321. To accomplish these ends, Congress imposed extensive procedural requirements on government action affecting the environment. Paramount among these were the requirements that all federal agencies shall, "to the fullest extent possible":

> (A) utilize a systematic, interdisciplinary approach which will insure the integrated use of the natural and social sciences and the environmental design arts in planning and in decisionmaking which may have an impact on man's environment;
>
> (B) identify and develop methods and procedures ... which will insure that presently unquantified environmental amenities and values may be given appropriate consideration in decisionmaking along with economic and technical considerations;
>
> (C) include in every recommendation or report on proposals for legislation and other major Federal actions significantly affecting the quality of the human environment, a detailed statement by the responsible official on--
>
> (i) the environmental impact of the proposed action,
>
> (ii) any adverse environmental effects which cannot be avoided should the proposal be implemented,
>
> (iii) alternatives to the proposed action,
>
> (iv) the relationship between local short-term uses of man's environment and the maintenance and enhancement of long-term productivity, and

(v) any irreversible and irretrievable commitments of resources which would be involved in the proposed action should it be implemented.

Id. § 4332(2). Congress further directed that, again "to the fullest extent possible," "the policies, regulations, and public laws of the United States shall be interpreted and administered in accordance with the policies set forth in this chapter." *Id.* § 4332(1). This unequivocal command has guided the United States' environmental policy for more than thirty years, and pervades every aspect of government decisionmaking.

B. Clean Air Act

Federal air quality legislation dates back to at least the mid-1950s, and the CAA itself to 1963, Pub.L. No. 88-206, 77 Stat. 393, but it was the substantial amendment in 1970, Pub.L. No. 91-604, 84 Stat. 1713, that gave the Act its modern, far-reaching scope. The Act was amended again to further broaden its reach in 1977, Pub.L. No. 95-95, 91 Stat. 749, and in 1990, Pub.L. No. 101-549, 104 Stat. 2399. Before the 1970 Amendments, there existed no federal air pollution standards, nor mandatory enforcement mechanisms; federal officials could only encourage states to develop air-quality enforcement programs. All this was dramatically altered by the 1970 Amendments, which mandated national air quality standards and deadlines for their attainment. Pub.L. No. 91-604, § 4, 84 Stat. at 1678-89. These amendments also created an innovative federal-state partnership structure whereby states were to develop individual "implementation plans" to attain compliance with federal standards, and the newly created Environmental Protection Agency ("EPA") was charged with evaluating, overseeing, and enforcing state compliance with these plans. *Id.* The 1970 Amendments specifically addressed for the first time hazardous pollutants and automobile exhausts, bringing these "mobile sources" within the scope of the EPA's authority. *Id.* §§ 6-9, 84 Stat. at 1690-700.

The 1977 Amendments added an important procedural safeguard: they forbade the federal government and its agencies from "engag[ing] in, support [ing] in any way or provid[ing] financial assistance for, licens[ing] or permit [ting], or approv[ing], any activity which does not conform to [an approved state] implementation plan." 42 U.S.C. § 7506(c)(1). The Act defined "conformity" broadly to include a restriction on such things as "increas[ing] the frequency and severity of any existing violation of any standard in any area," or "delay[ing] timely attainment of any standard ... in any area." *Id.* § 7506(c)(1)(B). This prevented the federal government from hindering states' abilities to comply with the Act's requirements. Finally, the 1990 Amendments vastly increased the list of regulated pollutants, as well as the EPA's civil and criminal enforcement capabilities.

C. North American Free Trade Agreement

On December 17, 1992, President William J. Clinton signed NAFTA, establishing a free-trade zone encompassing the United States, Canada, and Mexico. Upon submission to Congress, it was enacted into law as the North American Free Trade Agreement Implementation Act, Pub.L. No. 103-182, 107 Stat.2057 (1993) (codified as amended at 19 U.S.C. §§ 3301-3473) (effective Jan. 1, 1994).

NAFTA aimed to "CONTRIBUTE to the harmonious development and expansion of world trade and provide a catalyst to broader international cooperation" while "STRENGTHEN[ING] the development and enforcement of environmental laws and regulations." *Id.* pmbl., 32 I.L.M. at 297. Indeed, environmental concerns dominated the debate over NAFTA in the United States. President Clinton waited for over a year to submit the agreement to Congress while the parties negotiated a side agreement, the North American Agreement on Environmental Cooperation, Sept. 14, 1993, U.S.-Can.-Mex., 32 I.L.M. 1480. The NAFTA agreement itself explicitly permits member states to adopt or maintain

> standards-related measures, including any such measure relating to safety, the protection of human, animal or plant life or health, the environment or consumers ... includ[ing] those to prohibit the importation of a good of another Party or the provision of a service by a service provider of another Party that fails to comply with the applicable requirements of those measures or to complete the Party's approval procedures.

NAFTA art. 904(1), 32 I.L.M. at 387.[a]

The treaty as enacted into United States law specifically determined that in the case of a conflict between the treaty and federal law, federal law would prevail. 19 U.S.C. § 3312(a)(1) ("No provision of the Agreement ... which is inconsistent with any law of the United States shall have effect."). Congress also made clear that NAFTA cannot be construed "to amend or modify any law of the United States, including any law regarding ... the protection of human, animal, or plant life or health [or] the protection of the environment." *Id.* § 3312(a)(2).

II. PROCEDURAL HISTORY

. . .

On February 6, 2001, a specially convened treaty arbitral panel determined that the United States' continued refusal to permit the entry of Mexican trucks beyond the restricted border zones violated NAFTA. Thereafter, as recited in the EA [Environmental Assessment] prepared by DOT, President George W. Bush "announced his intent to comply [with this ruling] by modifying the moratorium, pursuant to his statutory authority, once FMCSA [was] ready to issue ... regulations governing Mexico-domiciled [trucks] seeking United States operating authority."

After the NAFTA arbitral panel issued its opinion, DOT published Notices of Rulemaking for the Application and Safety Rules on May 3, 2001. *See* 66 Fed.Reg. 22,371 (May 3, 2001) (Application Rule); 66 Fed.Reg. 22,415 (May 3, 2001) (Safety Rule). Meanwhile, in 1999, Congress had enacted the Motor Carrier Safety Improvement Act, mandating that DOT "complete a rulemaking to improve training and provide for the certification of motor carrier safety auditors ... to conduct safety inspection audits and reviews." 49 U.S.C. § 31148(a). The FMCSA was in the process of preparing these rules in 2001.

On December 18, 2001, the 2002 DOT Appropriations Act was signed into law. Pub.L. No. 107-87, 115 Stat. at 833. Section 350 of that Act provides:

> (a) No funds limited or appropriated in this Act may be obligated or expended for the review or processing of an application by a Mexican motor carrier for authority to operate beyond [the border zone] until the Federal Motor Carrier Safety Administration [issues safety and auditor-certification regulations, and conducts safety studies that meet certain specified criteria].
>
> ....
>
> (c) No vehicles owned or leased by a Mexican motor carrier may be permitted to operate beyond [the border zone] under conditional or permanent operating authority granted by the Federal Motor Carrier Safety Administration until--
>
> (1) the Department of Transportation Inspector General conducts a comprehensive review of border operations .... [and]
>
> (2) [t]he Secretary of Transportation certifies in writing in a manner addressing the Inspector General's findings ... that the opening of the border does not pose an unacceptable safety risk to the American public.

Id. § 350, 115 Stat. at 864-68 (codified at 49 U.S.C. § 13902 note).

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a. In portions of the NAFTA panel's initial decision not included in the excerpts from the decision, the panel discussed at length the possible implications of NAFTA Chapter 9, which both Mexico and Canada had anticipated that the United States would invoke. However, the United States did *not* invoke Chapter 9, and so the issue was not joined.

DOT subsequently modified the Application, Safety, and Certification Rules to comply with the requirements of the Appropriations Act. Recognizing the need to comply with the regulations implementing NEPA, DOT prepared a preliminary [EA] for the Application and Safety Rules, evaluating their likely environmental impact. DOT determined that a full Environmental Impact Statement ("EIS") was not required, concluding that the proposed rules did not "significantly affect[ ] the quality of the human environment." 42 U.S.C. § 4332(2)(C). Thus, it issued a Finding of No Significant Impact ("FONSI") along with the EA on January 16, 2002. DOT did not prepare an EA for the Certification Rule, because it determined that this regulation fell into the categorical exclusions from the EA/EIS requirement in the NEPA regulations. As a result, DOT also did not include the Certification Rule in its FONSI. Nor did DOT prepare a CAA conformity determination for any of the regulations because it determined that certain categorical exceptions to the conformity-determination requirement applied to them.

All three regulations were published in the *Federal Register* as "Interim Final Rules" on March 19, 2002. The Application Rule updates the requirements for Mexican carriers applying to use United States roads, including the applicants' ability to comply with certain United States truck safety regulations. *See* Application Rule, 67 Fed.Reg. at 12,735-40. Furthermore, the application form requires the carriers to agree to undergo pre-authorization safety audits, provide proof of insurance, and submit to inspection every three months. *Id.* at 12,715. The Safety Rule extends "provisional" operating authority to Mexican carriers for the first eighteen months they are licensed to enter the United States, subjecting them to intensified inspection during that period. Safety Rule, 67 Fed.Reg. at 12,771-73. Upon successful completion of this initial period, carriers become eligible to receive "permanent" operating authority, under which they remain subject to less intensive monitoring and inspection. *See id.* The Certification Rule establishes certification procedures for the requisite personnel to conduct safety and compliance inspections. Certification Rule, 67 Fed.Reg. at 12,779.

Petitioners filed a timely petition challenging the validity of the Application and Safety Rules on May 2, 2002 . . . and a timely petition challenging the validity of the Certification Rule on May 14, 2002. . . . Both petitions, alleging violations of the procedural requirements of NEPA and the CAA, were brought pursuant to the judicial review provision of the Administrative Procedures Act, 5 U.S.C. §§ 701-706 ("APA"). We have jurisdiction to review the petitions under 28 U.S.C. § 2342(3)(A), which provides for direct review in the court of appeals of certain administrative actions. We consolidated the petitions by an order dated May 22, 2002. On June 14, 2002, we permitted the Natural Resources Defense Council and the Planning and Conservation League to intervene on behalf of Petitioners.

The DOT Inspector General filed a report regarding his "comprehensive review of border operations" on June 25, 2002, and the Secretary of Transportation issued his written certification on November 20, 2002. As promised, following DOT's certification of its readiness to issue the regulations, President Bush modified the trucking moratorium (subsequent to oral argument) to permit Mexico-domiciled motor carriers to provide cross-border services. *See* Memorandum of November 27, 2002, 67 Fed.Reg. 71,795 (2002).[d] The moratorium remains in place now only as to Mexico-domiciled motor carrier services between points in the United States. *Id.*

III. STANDING

[The court considered the petitioners' standing to sue. Under applicable case law, it only needed to find one petitioner with standing to allow a case to proceed. *See, e.g., Chief*

Probation Officers v. Shalala, 118 F.3d 1327, 1331 (9th Cir.1997) (White, Justice, by designation) (indicating that evaluation of the standing of second plaintiff was "unnecessary to resolution of the case"); *Watt v. Energy Action Educ. Found.,* 454 U.S. 151, 160 (1981) ("There are three groups of plaintiffs in this litigation. . . . Because we find [that one of the groups] has standing, we do not consider the standing of the other plaintiffs."). At the petitioners' suggestion, the court considered only the standing of Public Citizen. The court concluded that Public Citizen's could satisfy constitutional requirements for standing, as well as the requirements for organizational[b] and statutory standing under the APA.[c]]

IV. STANDARD OF REVIEW

[The standard of judicial review of agency action to determine its conformity with NEPA and CAA was governed by the judicial review provisions of the APA, 5 U.S.C. §§ 701-706. The court held that it was required to determine whether agency actions were "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law." 5 U.S.C. § 706(2)(A). In the context of procedural environmental requirements imposed by NEPA and CAA, this standard required the court to ensure that the agency had taken the requisite "hard look" at the environmental consequences of its proposed action, carefully reviewing the agency record to determine if the agency decision was founded on a reasoned evaluation of the relevant factors. *See, e.g., Wetlands Action Network v. United States Army Corps of Eng'rs,* 222 F.3d 1105, 1114 (9th Cir.2000), *cert. denied,* 122 S.Ct. 41 (2001).]

V. ENVIRONMENTAL ANALYSIS UNDER NEPA

A. DOT's Decision Not to Prepare an EIS

We next determine whether DOT acted in an arbitrary and capricious manner when it failed to prepare an Environmental Impact Statement on the basis of its Environmental Assessment. By its own terms, NEPA intended to reorganize the priorities of the federal government, to integrate "environmental amenities and values" alongside more traditional "economic and technical considerations." 42 U.S.C. § 4332(2)(B). Congress directed that the statute and its implementing regulations be used toward this end in government decisionmaking "to the fullest extent possible." *Id.* § 4332. . . .

[T]o decide whether an EIS is required, we must determine: (1) whether the challenged rules constitute "major" federal actions; and (2) whether they may significantly affect the environment. We find that DOT's rules are major federal actions that may significantly affect the environment, and thus we hold that DOT acted in an arbitrary and capricious manner in failing to prepare an EIS for the challenged regulations. . . .

DOT acknowledges that "there are reasons to believe that [increased traffic and pollution] might occur," but it contends that these increases will be smaller than Petitioners suggest. Strangely, despite DOT's "reasons to believe" that such increases will occur, its EA does not address them. In fact, the EA specifically assumed for the purposes of its study that "the implementation of [the regulations] would not affect the trade volume between the United States [and] Mexico." It contends instead that any increases "would be the result of the modification of the moratorium and not the implementation of the [regulations]." Indeed, the EA asserts that the number of Mexican trucks in the United

b. *I.e.*, that Public Citizen was entitled to bring suit on behalf of its members. *Hunt v. Wash. State Apple Adver. Comm'n,* 432 U.S. 333, 343 (1977).

c. *I.e.*, that there has been final agency action adversely affecting it, and that, as a result, it has suffered legal wrong or that its injury falls within the "zone of interests" of the statutory provision the petitioner claims was violated. *Lujan v. Nat'l Wildlife Fed'n,* 497 U.S. 871, 882-83 (1990).

States will likely decrease as a result of the new regulations alone, because not all existing Mexican trucks currently operating in the border zone could or will comply with them. This illogical parsing of the cause of increased pollution, i.e., that decreases in truck traffic are credited to DOT's action, but the potentially much larger expected increases in the same traffic are attributed to the President's modification of the moratorium, dictates the EA's overall conclusions.

The EA goes on to evaluate the environmental effects of the regulations–attempting to segregate them from those attributable to the rescission of the moratorium–and concludes that the regulations will actually slightly reduce emissions by Mexican trucks within the border zone, and have no significant effect on air quality beyond the border zone, when evaluated on a national scale. This emissions analysis, in turn, is based on the EA's further assumptions regarding the quality and age of the Mexican truck fleet.

The EA assumes, without stating any basis therefor, that it "considered" approximately one-third of Mexican trucks to be identical to United States trucks manufactured after 1994, while considering the remaining trucks identical to United States trucks manufactured in 1986. (More precisely, the EA "considered" 130,000 of 400,000 Mexican trucks to be manufactured after 1994, and the rest in 1986, and then lamented the "significant confounding variable" in its study, that the analysis programs it used "were based on United States vehicles.") These years are significant because 1994 is the year after which Mexican emissions standards became equivalent to United States standards. The year 1986 was selected, according to DOT, because it was the last year when neither Mexico nor the United States had any relevant emissions regulations in place.

There are two problems with this analysis. First, the EA provides no basis whatsoever for its selection of one-third as the proportion of Mexican trucks manufactured after 1994. Other studies, though not part of the administrative record, have concluded that this percentage is closer to 20% (study by the General Accounting Office) or even 10% (private study commissioned by the California Attorney General). While we do not consider such studies to be conclusive, they are at least founded on some analysis of raw data, and based on some ascertainable methodology. The EA, on the other hand, seems to have randomly selected one-third as its preferred proportion, citing no authority or study for that number.

The second analytical defect echoes our concern regarding the EA's failure to consider long-term effects. The United States has already adopted much stricter emissions regulations that will become effective in 2004 and 2007. *See* 40 C.F.R. § 86.004-11 (2004); *id.* § 86.007-11 (2007). In addition, six major United States diesel truck engine manufacturers have entered into consent decrees in the District Court for the District of Columbia in settlement of CAA violations, in which they have agreed to abide by certain of the 2004 emissions regulations as of October 1, 2002. *See, e.g.,* Consent Decree, *United States v. Caterpillar, Inc.,* No. 98-02544(HHK) (D.D.C.1999). Neither the EA nor DOT cite to any known plans of the Mexican government to tighten its emissions standards beyond those currently in place. Indeed, the EA never even considered this issue because, as discussed above, it limited its analysis to the year 2002. The existence of regulations and consent decrees that will significantly alter the relative environmental impact of Mexican truck traffic in the near future would further strengthen the need for the EA to have considered future implications of its actions.

Thus, the EA–assuming no increase in Mexican truck traffic, making an arbitrary assumption about the percentage of newer, "cleaner" Mexican trucks on the roads, and failing to take account of future increasing discrepancies in emissions rules–conducted an environmental analysis that found no increase in emissions due to the regulations' implementation. Our law mandates that an agency complete an EIS "where uncertainty may be resolved by further collection of data, or where the collection of such data may prevent 'speculation on potential ... effects.' " . . . Petitioners raise many uncertainties about the EA, as does amicus the Attorney General of the State of California . . . and there is no suggestion that these uncertainties do not lend themselves to quantification. (Indeed,

Petitioners have submitted a number of studies attempting precisely what DOT should have done.)

[W]e do not wish to dictate the outcome of the analysis that DOT must perform. Perhaps DOT will determine that the new regulations will have only a minor impact–one which will be negligible in light of other factors. In the absence of such analysis, however, we cannot defer to the agency's assessment. . . .

The California Attorney General asserts that DOT failed to take account of California's emissions regulations, which are "more stringent than the federal standards." In its determination of whether its proposed action is significant, an agency must consider "[w]hether the action threatens a violation of Federal, State, or local law or requirements imposed for the protection of the environment." 40 C.F.R. § 1508.27(b)(10). . . . California has mandated the adoption of airborne pollutant standards for the state, Cal. Health & Safety Code § 39606 (West 2002), and has adopted rules setting specific limits for airborne pollutants, including NOx and PM-10, Cal.Code Regs., tit. 17, §§ 70100-200 (2002). Regardless of whether the influx of Mexican trucks will cause the levels of these pollutants to rise beyond California's air quality limits–an issue on which the record before us is insufficient–DOT had an obligation to consider whether its regulations *might* violate these rules.

The California Attorney General also points out that DOT's actions could violate the CAA, thus further triggering the illegality prong of the significance analysis. Because we find that DOT violated the CAA . . . , this further strengthens our conclusion that DOT's actions are environmentally significant for NEPA purposes. . . .

"Controversy" sufficient to require preparation of an EIS occurs "when substantial questions are raised as to whether a project . . . may cause significant degradation of some human environmental factor, or there is a substantial dispute [about] the size, nature, or effect of the major Federal action." . . . The evidence establishing such a controversy must be brought to the agency's attention while the agency is conducting its deliberations, not *post hoc*. . . . Thus, the controversy requirement is two-fold: Petitioners must show that there was a "substantial dispute" about DOT's actions and that this dispute raised "substantial questions" about their validity. The burden then shifts to DOT to provide a "convincing" explanation why no controversy exists. . . .

Petitioners' claim satisfies the first requirement. We have held that an " 'outpouring of public protest' "–where, for example, 85% of public comments opposed the proposed agency action–constitutes a substantial dispute. . . . Here, "[o]ver 90 percent of the comments opposed" DOT's regulations. Application Rule, 67 Fed.Reg. at 12,704. DOT timely received these comments, and duly noted their existence in the comments accompanying the final regulations. *See id.*

Petitioners' claim also satisfies the second requirement. A substantial portion of the negative comments offered real criticism of DOT's action. . . . Because many of these criticisms have merit, and DOT failed to adequately account for its failure to act on them, its action is "controversial" under the CEQ regulations and requires preparation of an EIS.

In sum, Petitioners have successfully demonstrated that DOT's proposed regulations may have a "significant" environmental impact, mandating the preparation of an EIS. DOT has failed to demonstrate that its EA contains anything close to the statutorily required "convincing statement of reasons" sufficient to support a decision not to prepare an EIS. We are similarly unpersuaded by DOT's last-ditch argument that, as an agency with no jurisdiction over environmental matters, it need not consider the environmental consequences of its actions. This argument flies in the face of the text of NEPA, which requires that "*all* agencies of the Federal Government shall . . .. include in every . . . major Federal action[ ] significantly affecting the quality of the human environment, a detailed statement by the responsible official on ... the environmental impact of the proposed action." 42 U.S.C. § 4332(2) (emphasis added).

One final point regarding the shortcomings of DOT's EA is that its analysis is limited

to comparing the status quo (the "Baseline Scenario") to the situation in which the regulations had been implemented (the "Proposed- Action Scenario"). By not considering additional alternatives (such as, for example, proposing more stringent controls on incoming Mexican trucks), DOT further failed to abide by NEPA's statutory command to prepare a "detailed statement ... on ... alternatives to the proposed action." 42 U.S.C. § 4332(2)(C); *see also* 40 C.F.R. § 1508.25(b)(2) (defining "[a]lternatives" to include "[o]ther reasonable courses of actions [sic]"). Indeed, the CEQ regulations state that consideration of alternatives "is the heart of the environmental impact statement." 40 C.F.R. § 1502.14. . . .

B. Categorical Exclusion of the Certification Rule

We next must determine whether DOT acted arbitrarily and capriciously in failing to conduct any NEPA environmental analysis at all for the Certification Rule. DOT contends that this rule falls within an exception to the generally applicable requirements of NEPA. The CEQ regulations allow categorical exclusion of actions "which do not individually or cumulatively have a significant effect on the human environment *and* which have been found to have no such effect in procedures adopted by a Federal agency in implementation of these regulations." 40 C.F.R. § 1508.4 (citing 40 C.F.R. § 1507.3) (emphasis added). For such actions, "neither an environmental assessment nor an environmental impact statement is required." *Id.*

Agencies are required to develop guidelines as to which of their actions do or do not require the preparation of an EA or an EIS. *See id.* § 1507.3. FMCSA, as a constituent agency, is subject to DOT's guidelines. *See* Dep't of Transp., Order 5610.1C, at ¶ 20(a)(2) (Sept. 18, 1979), *as amended* (July 13, 1982 and July 30, 1985), *available at* http://isddc.dot.gov [hereinafter "DOT Order 5610.1C"]. Individual agencies within DOT are permitted to issue their own guidelines, *id.* ¶ 20(a)(1), but FMCSA has not done so.

Therefore, we must examine DOT's Order to determine whether the Certification Rule falls within those categories of actions that it has "found to have no [environmental] effect." 40 C .F.R. § 1508.4. Paragraph 4(c) of the order specifies the categorical exclusions DOT employs. *See* DOT Order 5610.1C, at ¶ 4(c). The list includes such actions as "[a]dministrative procurements," "[p]ersonnel actions," and "[p]roject amendments (e.g. increases in costs) which do not significantly alter the environmental impact of the action." *Id.* There is no categorical exclusion that seems even plausibly capable of encompassing the Certification Rule. In effect, DOT is arguing that, even though the Certification Rule is not subject to any of DOT's categorical exclusions, it should be categorically excluded from the EA/EIS requirement because it has no significant environmental impact. This cannot be the case. . . .

. . . DOT has failed to identify any particular categorical exclusion applicable to the Certification Rule and may not do so post hoc. . . . Even if it could, any claim that one of these exclusions applied would be contrary to the plain text of the DOT Order, and thus "inconsistent with the terms used in the regulation," and not entitled to our deference. Thus, DOT acted in an arbitrary and capricious manner by failing to prepare an EIS, or at least in failing to prepare an EA for the Certification Rule and then determining on that basis whether to prepare an EIS.

VI. CONFORMITY DETERMINATION UNDER THE CAA

Petitioners also contend that DOT acted arbitrarily and capriciously in failing to conduct a conformity determination under the CAA. The CAA requires EPA to establish air quality standards for certain pollutants, 42 U.S.C. § 7409, and it has done so with respect to NOx and PM-10, the pollutants most at issue here, 40 C.F.R. § 50.6, .7, .11. . . .

To ensure compliance with these plans, the CAA contains a "conformity" requirement, mandating that "[n]o department, agency, or instrumentality of the Federal Government shall engage in, support in any way or provide financial assistance for, license or permit, or approve, any activity which does not conform to [a SIP]." *Id.* § 7506(c)(1). Most federal actions affecting levels of pollutants in nonattainment regions require that the responsible agency conduct a "conformity determination." 40 C.F.R. § 93.150-.160. However, two categories of federal action are exempted from this requirement: (1) "[a]ctions where the total of direct and indirect emissions are below the emissions level specified in [the regulations]," *id.* § 93.153(c)(1); and (2) "[a]ctions which would result in no emissions increase or an increase in emissions that is clearly de minimis," including "[r]ulemaking and policy development and issuance," *id.* § 93.153(c)(2). DOT argues that its regulations fall within both of the above-listed exceptions: that the total emissions caused by the regulations fall below the specified amount, and that the regulations are categorically excluded from the statutory requirements because they are "rulemaking." . . .

DOT's assessment that its regulations will cause emissions below the amounts specified in 40 C.F.R. § 93.153(b)(1), thus excusing it from making a conformity determination, is based on the predicted emissions in its EA. As we have already determined, however, DOT failed to conduct a reliable environmental analysis. Because of its illusory distinction between the effects of the regulations themselves and the effects of the presidential rescission of the moratorium on Mexican truck entry, DOT systematically underestimated the emissions that would result from its regulations. Furthermore, there were a number of methodological flaws in DOT's EA, including, most relevantly for CAA purposes, the failure to consider its regulations' environmental impact on a local or regional basis. . . .

VII. CONCLUSION

. . . We emphasize that we draw no conclusions about the actions of the President of the United States nor the validity of NAFTA, neither of which is before us. The only question before us is whether a federal agency failed to comply with our nation's long-established environmental laws. We hold that the Department of Transportation acted arbitrarily and capriciously in failing to prepare a full Environmental Impact Statement under the National Environmental Protection Act, as well as a conformity determination under the Clean Air Act. Therefore, we grant the petitions, and remand this matter to the Department of Transportation so that it may prepare a full Environmental Impact Statement and Clean Air Act conformity determination for all three regulations.

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